Supreme Court, U.S.
FILED
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No. _____

In The

Supreme Court of the United States

October Term, 1996

TRISTAR CORPORATION,

Petitioner,

v.

ROSS A. FREITAS and CAROLINE SAFER KENNER,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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103 pp

QUESTION PRESENTED

Whether the court of appeals for the Second Circuit erred in holding, in conflict with the long-standing decision of the court of appeals for the Ninth Circuit, that the limitations period for commencing an action under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), to recover short-swing profits, begins to run *prior* to the filing of the mandatory reports that provide the best, and in many cases, the exclusive source of notice of the transactions upon which such an action may be based.

LIST OF TRISTAR CORPORATION'S PARENT AND NONWHOLLY OWNED SUBSIDIARY COMPANIES

1. Tristar Corporation's parent companies are:

   a) Transvit Manufacturing Corp., and

   b) Starion International Ltd.

2. Tristar Corporation's nonwholly owned subsidiary companies are:

   a) Tristar de Mexico S.A. de C.V.,

   b) Tristar do Brasil Cosmeticos, Ltda., and

   c) Cosmeticos Tristar de Venezuela C.A.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Tristar Corporation hereby petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. *infra*, 1) is reported. *See Tristar Corp. v. Freitas*, 84 F.3d 550 (2d Cir.), *reh'g denied* (1996). The opinion of the district court (App. *infra*, 12) is reported. *See Tristar Corp. v. Freitas*, 867 F. Supp. 149 (E.D.N.Y. 1994).

JURISDICTION

The judgment of the court of appeals was entered on May 21, 1996. On July 18, 1996, the court of appeals denied Petitioner's timely motion for rehearing and suggestion for rehearing *en banc*. App. *infra*, 27. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78p(a) and 78p(b), and Rule 16a-3, 17 C.F.R. § 240.16a-3. App. *infra*, 29.

STATEMENT

1. Congress enacted Section 16(b) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. § 78p(b), to prevent "the unfair use of information which may have been obtained by [the corporate insider] by reason of his relationship to the issuer." Section 16 applies to any director or executive officer, and to any owner of more than ten percent of any class of equity securities registered under Section 12 of the Act ("Section 16 insider" or "insider").

Section 16(b) provides a unique cause of action, in favor of the issuer of such securities (or, if the issuer fails to act, any security holder of the issuer) to recover "short-swing" profits realized by any Section 16 insider. *Gollust v. Mendell*, 501 U.S. 115 (1991). A "short-swing" transaction consists of two separate events – a purchase and a sale – by a Section 16 insider within a period of less than six months. Liability under Section 16(b) is automatic, and is imposed without regard to the intent of the Section 16 insider. Under Section 16(b), any purchase may be matched against any sale within the six-month statutory period, and in the case of multiple transactions, the highest sale price is matched against the lowest purchase price, so as to maximize the profit to be returned to the issuer. *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

This Court has observed that "the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co. v. Emerson Electric*

Co., 404 U.S. 418, 422 (1972); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 592 (1973).

The statute provides that "[s]uit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer . . . " 15 U.S.C. § 78p(b). Section 16(b) further provides that "no suit shall be brought more than two years after the date such profit was realized." 15 U.S.C. § 78p(b).

Section 16(a) requires each Section 16(b) insider to "file with the Commission . . . a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month." 15 U.S.C. § 78p(a). Among other things, the Section 16(a) reporting requirement serves to reveal the existence of an insider's short-swing transactions, if and when the report is filed. *See Whittaker v. Whittaker Corp.*, 639 F.2d 516, 528 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). App. *infra*, 61-62. The SEC, in implementing Section 16(a), requires a report, called a Form 4, to be filed within ten days after the end of a month in which a change occurs in an insider's holdings. Since May 1, 1991, SEC rules have provided that certain transactions are reportable on a different form, Form 5, which is to be filed within forty-five days of the end of the issuer's fiscal year. Section 16(a) reports must be filed with the issuer, the SEC, and any national stock exchange on which the issuer's equity securities are traded. Such reports become matters of public record.

As the court of appeals stated below, "[w]here the requirements of Section 16(a) are met, the corporation or shareholder may determine easily and quickly whether any statutory insider has profited from a short-swing transaction by examining the Form 4s filed each month with the Commission. The corporation or shareholder may then use the Form 4s to establish liability in an action under section 16(b)." App. *infra*, 6. Once an action is initiated, recovery "is virtually automatic," App. *infra*, 7, since the "statute imposes liability without fault." App. *infra*, 6 (*quoting Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 251 (1976)).

2. On December 16, 1993, Petitioner Tristar Corporation ("Tristar") commenced this action in the United States District Court for the Eastern District of New York pursuant to 28 U.S.C. § 1331 against defendants Ross Freitas and Carolyn Safer Kenner to recover short-swing profits realized by defendants in transactions involving the securities of Tristar's predecessor corporation, Ross Cosmetics ("Ross"). At the time of the transactions at issue, the equity securities of Ross were registered pursuant to Section 12 of the Securities Exchange Act, and both defendants were directors and officers of Ross, as well as beneficial owners of more than ten percent of the outstanding shares of Ross. App. *infra*, 3. Accordingly, defendants were "insiders" subject to the short-swing profit disgorgement provisions of Section 16(b) and the reporting/disclosure requirements of Section 16(a).

Between February 2, 1989 and June 15, 1989, the defendants made several purchases of Ross stock. App. *infra* 14. On May 31, 1989, defendants entered into a

contract to sell approximately 28 percent of the then-outstanding shares of Ross common stock. App. *infra*, 13. The district court, matching the purchases with the May 31 sale, determined that defendants reaped a short-swing profit of more than $180,000. App. *infra*, 22.

There is no dispute that the defendants filed the Section 16(a) report for the May 31, 1989 sale on "December 18, 1991 – over two and one-half years after the filings were due." App. *infra*, 5.

3. In the district court, the defendants contended that Tristar's complaint was not timely filed. The district court, relying on long-standing precedent of the Ninth Circuit court of appeals, *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981), held that the two-year limitations period was tolled until the insiders filed the Section 16(a) report of the event that gave rise to a short-swing transaction. App. *infra*, 20-21. The district court determined that since the defendants had not filed the Section 16(a) report of the May 31, 1989 sale until December 18, 1991, the two-year limitations period did not begin to run until the date of filing. *Id.* Tristar, in reliance on the *Whittaker* rule, commenced its action on December 16, 1993, within two years of the filing of the Section 16(a) report; accordingly, the district court determined that the action was timely, App. *infra*, 21, and entered summary judgment in Tristar's favor. App. *infra*, 24.

The court of appeals reversed, finding that Tristar's complaint was not filed within the limitations period. App. *infra*, 9. In so doing, the court of appeals pointedly rejected the *Whittaker* position: "We thus disagree with

the approach taken by the Ninth Circuit in *Whittaker*, 639 F.2d at 530 (and by the district court in this case, 867 F. Supp. at 154), which *restarts* the two-year limitations period on the date that the (untimely) Form 4s are filed." App. *infra*, 8 (emphasis in original).

In lieu of the *Whittaker* rule, the court of appeals adopted a new test for reckoning the limitations period whereby the period begins to run *before* the Section 16(a) report is filed. Specifically, the court held that: (a) the two year limitations period *begins* to run on the date when a purchase (or sale) occurs; (b) the limitations period *continues* to run until the *last* date on which the insider may timely file the Section 16(a) report disclosing the transaction; (c) if the insider fails to file by the *last* day permitted under Section 16(a), the limitations period is tolled until the Section 16(a) report is actually filed; and (d) once the Section 16(a) report is actually filed, the limitations period begins to run again. App. *infra*, 8-9.

Applying the new rule in this case, the court of appeals calculated the limitations period as follows: (a) the two-year limitations period began to run on May 31, 1989; (b) it continued to run for ten days, until June 10, 1989, the last day when the defendants could have filed a timely Section 16(a) report for the May 31, 1989 transaction; (c) the limitations period was tolled from June 10, 1989 until December 18, 1991, when defendants belatedly filed the report; and (d) the limitations period began running again on December 18, 1991, at which time anyone seeking to initiate an action to recover the short-swing profits had two years *minus ten days* – or until December 8, 1993 – to commence their action. App. *infra*, 8-9. The court held, therefore, that Tristar's December 16,

1993 complaint was eight days late and must be dismissed with prejudice. App. *infra*, 9.

REASONS FOR GRANTING THE PETITION

The decision of the Second Circuit court of appeals directly conflicts with the rule of the Ninth Circuit in *Whittaker* and contravenes Congress' express goal of curbing insider trading abuses. The conflict in the circuits is of importance to the shareholders of each of the companies that have registered a class of equity securities under Section 12 of the Securities Exchange Act – *i.e.*, all companies whose stock is traded on the New York Stock Exchange, the American Stock Exchange, the several regional exchanges (Boston, Philadelphia, Pacific, Midwest), the National Association of Securities Dealers Automated Quotation System, and in certain companies traded on the over-the-counter market.

The Second Circuit's rule for calculating the period of limitations is incompatible with the purpose of Section 16(b), and is based on an erroneous assumption regarding the relationship of Sections 16(b) and 16(a). Moreover, the rule results in a limitations period that is difficult to calculate in each case, depending upon the "timeliness" of the Section 16(a) report under the SEC's rules.

The Second Circuit assumed that the greatest period of time that could elapse between a purchase or sale and the timely report of the purchase or sale was forty days, and the least amount of time was ten days. In fact, under the Commission's reporting rules, a period of more than one year – as much as 410 days – may elapse between the

occurrence and the timely reporting of the purchase or sale. *See* Rule 16a-3, 17 C.F.R. § 240.16a-3 (1996), App. *infra*, 31.

Under the rule adopted by the court of appeals, the two-year period begins to run when *only* the insider knows of the transaction, and without regard to whether the insider files the Section 16(a) report timely. From the standpoint of the beneficiaries of Section 16(b) – the security holders of the issuer – it makes no difference whether the Section 16(a) report was filed timely or untimely: security holders cannot know of the existence of a matchable purchase or sale transaction until the report is actually filed.

1. As the court of appeals recognized in this case, it has adopted an interpretation of the limitations period of Section 16(b) of the Act that is in direct conflict with the interpretation adopted by the Ninth Circuit fifteen years ago in *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir. 1981) (App. *infra*, 35). App. *infra*, 8. This direct conflict between two of the courts of appeals most likely to address Section 16(b) issues requires resolution by this Court and provides a compelling reason for granting *certiorari*.

In *Whittaker*, the court of appeals for the Ninth Circuit, after consideration of the possible competing interpretations of Section 16(b)'s statute of limitations and the terms of Section 16(a), concluded that the two year limitations period "is tolled *until the insider discloses the transactions* at issue in his mandatory § 16(a) reports," App.

infra, 59-60 (emphasis added).[1] The *Whittaker* rule is consistent with the interpretation of most courts and commentators.[2]

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[1] This so-called "disclosure" interpretation, which affords both the issuer and its shareholders an opportunity to discover the transactions, accords with the well-established doctrine that "where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered. . . . " *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 347 (1874). This doctrine is "read into every federal statute of limitations." *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946); *see also Exploration Co. v. United States*, 247 U.S. 435, 449 (1918) (Congress is presumed to have passed a statute of limitations with the "established doctrine" of *Bailey v. Glover* in mind).

This Court recently reaffirmed that the "venerable principle" of *Bailey v. Glover* applies "in the usual case," but declined to apply it to causes of action under Section 10(b) of the Act because "tolling doctrine is fundamentally inconsistent with the 1-and-3-year structure" of the applicable statute of repose. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363. "The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling." *Id.* The 1-and-3-year statute of repose at issue in *Lampf* does not apply to Section 16(b). *See id.* at 360, n.5.

[2] *See, e.g., Grossman v. Young*, 72 F. Supp. 375, 376-78 (S.D.N.Y. 1947) (insider's failure to file disclosure statements required by Section 16(a) for more than two years after the transactions at issue prevents the running of the limitations period: "It is incongruous to permit an insider to escape repayment of his profits by compounding his fault in failing to file the required reports." *Id.* at 378.); *Blau v. Albert*, 157 F. Supp. 816, 819 (S.D.N.Y. 1957) (Section 16(b) action timely as long as it is brought within two years of the date the insider files his disclosure report, even if the action is filed more than two years after the date of the transaction); *Shattuck Denn Mining Corp. v.*

In addition to the confusion and lack of uniformity inherent in the Second Circuit's rejection of the *Whittaker* approach, the new rule would lead to anomalous results which the court of appeals apparently did not consider due to its mistaken belief that the maximum impact of its new rule would be slight. The court erroneously assumed that *all* Section 16(a) reports are required to be filed no later than the tenth calendar day of the month following

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La Morte, Fed. Sec. L. Rep. (CCH) ¶ 94,429 (S.D.N.Y. 1974) (same); *but see Carr-Consolidated Biscuit Co. v. Moore*, 125 F. Supp. 423 (M.D. Pa. 1954) (the two-year limitations period runs from the date of transaction, but the court refused to dismiss the complaint until after providing the plaintiff with an opportunity to demonstrate the existence of collusion between insider and issuer in failing to file a Section 16(b) complaint sooner).

See also Steinberg and Lansdale, *The Judicial and Regulatory Construction of Section 16(b) of the Securities Exchange Act of 1934*, 68 Notre Dame L. Rev. 33, 59 (1992) (supporting *Whittaker* rationale and observing: "Allowing [insiders] to successfully raise the statute of limitations defense when they have failed to comply with Section 16(a) would thwart Congress' objectives in enacting that provision"); Cook and Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harvard L. Rev. 385, 413 (1953) (arguing that tolling of Section 16(b) limitations period is appropriate and consistent with the policy of the provision and that an insider's failure to disclose the transaction "prevent[s] the statute from running."); Rubin and Feldman, *Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders*, 95 U. Pa. L. Rev. 468, 473-4 (1947) (arguing that the limitations period "must be read in light of the purpose of Section 16(b) and the decisions construing comparable federal statutes . . . the time would not begin to run until plaintiffs in a Section 16(b) action have discovered or with reasonable diligence should have discovered the transactions which form the basis for the action.").

the month in which the transaction occurred. Accordingly, the court reasoned that the maximum period during which the limitations period would begin to run – before being tolled by the failure to file a timely disclosure – would be 40 days. App. *infra*, 8 at n.1 ("For example, if an insider earned a short-swing profit on May 1, 1989, that transaction would not need to be disclosed until June 10, 1989"). This assumption was plainly wrong.

The Securities and Exchange Commission's Section 16 reporting rules (the "1991 Rules"), in some circumstances, provide that reports of certain transactions need not be made until more than one year after the date of the transaction;[3] among other things, a Section 16(a) insider may delay the "timely" filing of a Section 16(a) report for certain transactions for a period of up to 45 days after the end of the issuer's fiscal year, where the insider "claims" the availability of an exemption from Section 16(b). *See* Rule 16a-3, 17 C.F.R. § 240.16a-3 (1996), App. *infra*, 31.[4] Applying the court of appeals' new standard to the full range of "timely" reporting under Section 16(b) would yield the following anomalous result: If an insider effects

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[3] The 1991 Rules, App. *infra*, 31, were adopted in Exchange Act Rel. No. 28869 (Feb. 8, 1991), and became effective on May 1, 1991. Although the 1991 Rules have recently been amended, Exchange Act Rel. No. 37260 (May 31, 1996) (effective August 15, 1996), they do not affect any of the insider filing reports at issue in this matter.

[4] The mere claim of an exemption preserves the timeliness of the filing, even though the claim itself does not establish that the exemption is in fact available. *See Stella v. Graham-Paige Motors Corp.*, 132 F. Supp. 100, 110-11 (S.D.N.Y. 1955), *aff'd*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956).

a transaction on January 1, and the issuer has a December 31 fiscal year-end, the Section 16(a) report for that transaction would not be due until February 14 of the following year – or 410 days after the date of the transaction, rather than the maximum 40-day period assumed by the court. Under the rule adopted by the court of appeals, since the limitations period runs between the date of the transaction and the *last* day when the report may be timely filed, all 410 days would be counted against the limitations period, whether or not the insider thereafter delayed in filing the report. The security holder who first learns of the transaction on the day it is disclosed would have less than eleven months to investigate whether the claim to exemption was well-grounded and to initiate his lawsuit under Section 16(b), substantially less time than the two-year period which Congress specifically provided in the statute.

In breaking with *Whittaker* and adopting a new rule for determining the limitations period, the court of appeals simply did not credit the potential for enormous reductions in the limitations period.[5] Now, with this new standard in place, the potential for wildly disparate decisions and results in the Ninth and Second Circuits is great and, for that reason, the split in the courts of appeals should be settled by this Court.

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[5] The full implications of the court of appeals' new rule may not have been appreciated by the court because neither party addressed, let alone advanced, either in the district court or on appeal in the Second Circuit, the interpretation ultimately adopted by the court of appeals. The court of appeals did not have the benefit of briefing or oral argument on its interpretation of Section 16(b).

2. The court of appeals' new limitations period test runs counter to Section 16(b)'s express goal of "preventing the unfair use of information which may have been obtained by [the insider] by reason of his relationship to the issuer." 15 U.S.C. § 78p(b). Congress enacted Section 16(b) to protect "outside" shareholders from the schemes of insiders. *See* S. Rep. No. 73-1455, at 55, 68 (1934). This Court has recognized that this statute was the "only method Congress deemed effective to curb insider trading abuses." *Reliance Electric Co.*, 404 U.S. at 422. The statute also serves to ensure that the shareholders are recompensed for the insider's short-swing trading profits. *See American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1060 (2d Cir. 1974) ("profits were to be restored to the presumptively aggrieved *cestui que trust*, the issuer of the securities"), *cert. denied*, 421 U.S. 1000 (1975).

The new rule imposed by the Second Circuit ignores the twin propositions recognized in *Grossman v. Young*, 72 F. Supp. 375 (S.D.N.Y. 1947), that (i) the consummation of a short-swing transaction itself gives rise to a cause of action, but (ii) that until the outside shareholders of the issuer have notice of the transaction, they cannot know of or pursue the cause of action. To commence the running of the limitations period before even the most diligent shareholders can have any knowledge of the cause of action is contrary to Congress' stated purpose of the statute.[6]

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[6] The statute expressly provides for a two-year limitations period. 15 U.S.C. § 78a(b). As explained in note 1, *supra*, tolling is read into every federal statute of limitations in which Congress did not clearly establish a policy of absolute repose. In

3. The court of appeals' ill-conceived rule was not even applied properly in this case, reflecting that the effects of the Second Circuit's decision were not fully considered by that court. The essential prerequisite to instituting an action under Section 16(b) is the existence of a "matchable" purchase and sale by the insider in any given six month period, and an allegation that profit was realized. If no profit was realized, there is no proper cause of action, and the complaint may be dismissed. *See, e.g., Blau v. Ogsbury*, 210 F.2d 426, 427 (2d Cir. 1954); *S. & S. Realty Corp. v. Kleer-Vu Industries, Inc.*, 575 F.2d 1040 (2d Cir. 1978).

Although the court of appeals recognized that Tristar's complaint alleged that defendants made purchases as late as June 1989, App. *infra*, 3, it erroneously assumed that only purchases during the six months preceeding May 31, 1989 were matchable with the May 31, 1989 sale. The May 31, 1989 sale was, of course, equally available for matching with the purchases occurring in the subsequent six-month period. *See Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). Here, the existence of purchases in June 1989 make clear that the court erred in using May 31, 1989 as the date on

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addition to ignoring this well-established principle, the construction of the limitations period advanced by the court of appeals does not comport with the Act's structure and stated remedial goal. Thus, even if the court of appeals' construction of the statute were a reasonable one, it cannot stand. "[W]here alternative constructions of the terms of 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co.*, 404 U.S. at 424.

which all Section 16(b) causes of action had accrued. *See Kornfeld v. Eaton*, 327 F.2d 263, 265 (2d Cir. 1964) (reflecting Commission's interpretation that Section 16(b) limitations period "commences on the date of sale (or purchase, if that is later)"); *Morales v. Mylan Laboratories, Inc.*, 443 F. Supp. 778, 780 (W.D. Pa. 1978) (limitations period begins to run on date of last transaction which is used to calculate insider's profit); *Sonics International*, 387 F. Supp. at 743 (same). Even though a Section 16(a) report had been filed for the June 1989 purchases by July 24, 1989, the Section 16(b) significance of the reported June 1989 purchase was unknown until the report of the May 1989 sale was filed in December of 1991. That the court of appeals erred in dismissing the entire complaint, without analyzing the limitations period applicable to these post-May 31, 1989 matching transactions by the insiders, is reflective of the court of appeals' ill-considered adoption of its new statute of limitations test.[7]

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[7] *See, e.g., Blau v. Mission Corp.*, 212 F.2d 77, 79-80 (2d. Cir.) (finding dismissal of Rule 16(b) action on limitations grounds inappropriate since at least some of the transactions took place within the requisite period), *cert. denied*, 347 U.S. 1016 (1954).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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October 11, 1996

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 1305 – August Term 1995

(Argued: April 5, 1996 Decided: May 21, 1996)

Docket No. 95-7952

TRISTAR CORPORATION,

Plaintiff-Appellee,

-v.-

ROSS A. FREITAS and CAROLYN SAFER KENNER,

Defendants-Appellants.

Before: KEARSE, JACOBS and CABRANES, *Circuit Judges.*

Appeal from a judgment of the United States District Court for the Eastern District of New York (Dearie, *J.*), granting summary judgment in favor of plaintiff Tristar on its action, brought pursuant to section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), to recover short-swing profits allegedly realized by defendants Ross A. Freitas and Carolyn Safer Kenner. On appeal, the defendants contend that Tristar's complaint was not filed within the two-year period of limitations set forth in section 16(b), and that the district court erred by

equitably tolling that period of limitations to render timely Tristar's complaint.

Reversed.

ANTHONY C. CIANCIOTTI, Fried, Frank, Harris, Shriver & Jacobson, Washington, D.C. (Elliot E. Polebaum, Washington, D.C., on the brief), *for Plaintiff-Appellee.*

CHASE A. CARO, Caro & Graifman, New York, NY, *for Defendants-Appellants.*

JACOBS, *Circuit Judge*:

Tristar Corporation ("Tristar") brought this action pursuant to section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), to recover short-swing profits allegedly realized by defendants Ross A. Freitas and Carolyn Safer Kenner through the purchase and sale of securities of Ross Cosmetics Distribution Centers, Inc. ("Ross Cosmetics"), later renamed Tristar. On July 20, 1994, Tristar moved for summary judgment. As an affirmative defense to that motion, the defendants, appearing *pro se*, contended that Tristar's complaint was filed after the two-year period of limitations set forth in section 16(b) had expired. The United States District Court for the Eastern District of New York (Dearie, *J.*) found that the defendants had failed to make the mandatory filings with the Securities and Exchange Commission (the "Commission") that would have provided Tristar with notice of the short-swing transactions and, for that reason, equitably tolled the two-year limitations period for a period sufficient to render timely Tristar's complaint. *Tristar v.*

Freitas, 867 F. Supp. 149, 153-54 (E.D.N.Y. 1994). Accordingly, the district court granted summary judgment in favor of Tristar.

On appeal, the parties ask us to decide whether the limitations period set forth in section 16(b) is subject to equitable tolling. We need not decide that question because, even assuming *arguendo* that the defendants' non-compliance with the filing requirements of the Securities Exchange Act tolled the limitations period, Tristar's complaint was still untimely filed. We therefore reverse the district court's grant of summary judgment in favor of Tristar.

BACKGROUND

From 1982 through at least May 31, 1989, defendants Freitas and Kenner served as officers and directors of Ross Cosmetics and were beneficial owners of more than ten percent of the outstanding shares of the company's common stock. In separate transactions occurring in February, March, May and June 1989, the defendants purchased more than 39,000 shares of Ross Cosmetics at prices ranging from $1.10 to $4.50 per share.

On May 31, 1989, the defendants entered into a binding contract (the "Agreement") to sell to Starion International Limited ("Starion") a total of 906,594 shares of Ross Cosmetics common stock, approximately 28 percent of the company's outstanding shares. The Agreement, which was styled a "Periodic Loan Agreement" by the contracting parties, required the defendants to transfer the shares to Starion in more than a dozen installments. In return, the defendants were to receive "loan disbursements"

fixed at between approximately $4.65 and $7.50 for each share in each installment. Through this transaction (and others), Starion acquired control of Ross Cosmetics (which was later re-named Tristar).

On December 16, 1993, Tristar filed its complaint pursuant to section 16(b) of the Securities Exchange Act to recover the defendants' short-swing profits. Section 16(b) permits a corporation or shareholder to bring an action for recovery of profits that a director, officer or principal shareholder realizes by purchasing and selling stock within a six-month period. 15 U.S.C. § 78p(b). Tristar alleged that from February 1989 to June 15, 1989 the defendants purchased shares of Ross Cosmetics at prices from $1.10 to $4.50 per share, and that the defendants then realized a profit exceeding $270,000 on those shares by selling them to Starion, pursuant to the Agreement, at prices between approximately $4.65 and $7.50 per share.

On July 20, 1994, Tristar moved for summary judgment. In an opinion dated November 9, 1994, the district court determined that the Agreement constituted a "sale" of securities as defined by section 3 of the Securities Exchange Act, 15 U.S.C. § 78c(a)(14). 867 F. Supp. at 153. The court also found that the defendants had reaped short-swing profits by entering into the Agreement with Starion, giving rise to a cause of action that accrued on May 31, 1989. *Id.* at 152-53. But because the two-year period of limitations set forth in section 16(b) expired on May 31, 1991, the district court found that Tristar's complaint (filed on December 16, 1993) was "clearly untimely." *Id.* at 153. No one appeals these determinations.

However, the district court found that circumstances warranted granting Tristar equitable relief. Because the Agreement was entered into on May 31, 1989, each defendant was required by section 16(a) to disclose the transaction on or before June 10, 1989 in a filing – designated a "Form 4" – with the Commission. *See* 17 C.F.R. § 240.16a-3(a) (1995). The defendants, however, failed to file Form 4s until December 18, 1991 – over two and one-half years after the filings were due. Tristar contended that it was thus deprived during that period of notice of the defendants' short-swing transactions. The district court, relying on the Ninth Circuit's decision in *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 527-30 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981), held that section 16(b)'s two-year period of limitations was equitably tolled during the defendants' delinquency. 867 F. Supp. at 153-54. The district court then determined (as did the Ninth Circuit in *Whittaker*) that the two-year limitations period began to run on the date that the defendants filed their (untimely) Form 4s – on December 18, 1991. *Id.* at 154. The court therefore held that Tristar's complaint, which was filed on December 16, 1993, was timely under section 16(b), and entered judgment against Freitas for $101,004.00, and against Kenner for $81,893.75, plus pre-judgment interest.

DISCUSSION

Section 16 of the Securities Exchange Act is intended "to curb short-swing trading by insiders whose position gives them access to information not available to the investing public." *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 592 n.23 (1973). Section 16(b) permits a shareholder or corporation to maintain an

action against any director, officer or beneficial owner of more than 10% of any class of outstanding shares (a "statutory insider") who profits from short-swing transactions in that corporation's securities. 15 U.S.C. § 78p(b). A short-swing transaction is "any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months." *Id.* A suit to recover such profits may be brought "by the issuer, or by the owner of any security of the issuer . . . in behalf of the issuer . . . ; *but no such suit shall be brought more than two years after the date such profit was realized.*" *Id.* (emphasis added).

Section 16(a) provides a mechanism for facilitating the recovery of short-swing profits by requiring statutory insiders to disclose any change in ownership "within ten days after the close of each calendar month" in which such change occurs. *Id.* § 78p(a). That disclosure is made via a Form 4 (filed with the Commission and made publicly available, *see* 17 C.F.R. § 240.16a-3(a) (1995)) which sets forth the insider's name, the date of the transaction, the number of shares sold or bought and the price per share. *See* Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 56 Fed. Reg. 7242, 7278-81 (Feb. 21, 1991) (instructions for Form 4). Where the requirements of section 16(a) are met, the corporation or shareholder may determine easily and quickly whether any statutory insider has profited from a short-swing transaction by examining the Form 4s filed each month with the Commission. The corporation or shareholder may then use the Form 4s to establish liability in an action under section 16(b). Because the "statute imposes liability without fault within its narrowly

drawn limits," *Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 251 (1976), recovery in such actions "is virtually automatic." *Whittaker*, 639 F.2d at 522.

We have held that a federal statute of limitations may be equitably tolled when "fraudulent or other conduct conceal[s] the existence of a claim." *Bowers v. Transportacion Maritima Mexicana, S.A.*, 901 F.2d 258, 264 (2d Cir. 1990). Where a claim has already accrued at the time of the defendant's improper conduct, courts suspend the *further* running of the limitations period until the claim is (or should be) known to the plaintiff, or until the improper concealment has ceased: "Equitable tolling of a statute means only that the running of the statute is suspended, not that the limitations period begins over again." *Benge v. United States*, 17 F.3d 1286, 1288 (10th Cir. 1994) (quotation marks omitted). *See also Singletary v. Continental Ill. Nat'l Bank & Trust Co.*, 9 F.3d 1236, 1241 (7th Cir. 1993) (discussing equitable estoppel); *Bowers*, 901 F.2d at 264.

The period of limitations begins running under section 16(b) on the "date [the short-swing] profit was realized." 15 U.S.C. § 78p(b). No appeal is taken from the district court's finding that short-swing profits were "realized" on the date that the Agreement was entered into – May 31, 1989 – and therefore that Tristar's claim accrued on that date. But the defendants were under no obligation under section 16(a) to disclose any transaction occurring in May 1989 until June 10, 1989. *See* 15 U.S.C. § 78p(a). So Tristar's putative ignorance of the claim *prior to June 10, 1989* did not result from the lateness of the

defendants' filings.[1] Equitable tolling would therefore be unwarranted during the period from May 31, 1989 to June 10, 1989. We thus disagree with the approach taken by the Ninth Circuit in *Whittaker*, 639 F.2d at 530, (and by the district court in this case, 867 F. Supp. at 154) which *restarts* the two-year limitations period on the date that the (untimely) Form 4s are filed.

The defendants failed to make the requisite filings with the Commission until December 18, 1991. That period of delay – from June 10, 1989 to December 18, 1991 – arguably deprived Tristar of notice required by law.[2] We therefore hold that any limitations period ran from the date on which Tristar's claim accrued (May 31, 1989) until the last date on which the defendants could have timely filed their Form 4s (June 10, 1989), *i.e.*, for ten days; that any suspension of the limitations period began on that

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[1] Because a Form 4 need not be filed until ten days after the month in which an insider transaction occurs, *see* 15 U.S.C. § 78p(a), a shareholder or corporation could be deprived of notice that a cause of action has accrued for a period of up to 40 days. For example, if an insider earned a short-swing profit on May 1, 1989, that transaction would not need to be disclosed until June 10, 1989.

[2] On June 5, 1989, Ross Cosmetics filed a Form 8-K (which is required to be filed when a change of control of the registrant occurs, *see* 17 C.F.R. § 249.308 (1995)) with the Commission disclosing the Agreement. There is therefore record evidence that Tristar – which, as noted, is controlled by Starion, the same entity that purchased the defendants' shares – had actual and contemporaneous notice of the defendants' short-swing profits. However, because we hold that Tristar's complaint would not be timely even if the limitations period were tolled, we need not decide whether Tristar's putative knowledge renders the equitable tolling doctrine inapplicable.

date and continued until the date on which the Form 4s were actually filed (December 18, 1991); and that the remaining limitations period of two years less ten days began running on that date. Tolling the period of limitations in this manner would extend the time in which Tristar could have brought an action from May 31, 1991 (the date on which the limitations period would otherwise have expired) to December 8, 1993.

Tristar's complaint, of course, was not filed until December 16, 1993. Thus, even if section 16(b) is subject to equitable tolling, Tristar's complaint would be untimely anyway. We therefore reverse the district court's entry of judgment for Tristar and direct the court to dismiss Tristar's complaint.

CONCLUSION

The judgment of the district court is reversed, and the district court is directed to dismiss the complaint.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

MANDATE

GEORGE LANGE III
CLERK

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 21st day of May, one thousand nine hundred and ninety-six.

PRESENT: HON. Amalya L. Kearse
HON. Dennis G. Jacobs
HON. José A. Cabranes

Circuit Judges

Docket No: 95-7952

TRISTAR CORPORATION,

Plaintiff-Appellee,

-v-

ROSS A. FREITAS and CAROLYN SAFER KENNER,

Defendants-Appellants.

Appeal from United States District Court for the Eastern District of New York.

This cause came on to be heard on the transcript of record from the Eastern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby **ORDERED, ADJUDGED, and DECREED** that the judgment of said district court be and it hereby is reversed in accordance with the opinion of this court.

For the Court
GEORGE LANGE III, Clerk
By:

/s/ Arthur M. Heller
Arthur M. Heller
Administrative Attorney

UNITED STATES DISTRICT
COURT EASTERN DISTRICT OF
NEW YORK

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TRISTAR CORPORATION,

Plaintiff,

- against -

ROSS A. FREITAS and CAROLYN
SAFER KENNER,

Defendants.

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CV-93-5722 (RJD)

MEMORANDUM AND ORDER

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DEARIE, District Judge.

Preliminary Statement

Plaintiff, Tristar Corporation ("Tristar"), formerly known as Ross Cosmetics Distribution Centers Inc. ("Ross Cosmetics"), brings this action pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C.

§ 78p(b) ("the Act"), to recover short swing profits from defendants Ross A. Freitas and Carolyn Safer Kenner. "For the purpose of preventing the unfair use of [inside] information," section 16(b) requires statutory insiders to disgorge to the issuer any "profit" realized from any purchase and sale (or sale and purchase) of securities occurring within a six month period. 15 U.S.C. § 78p(b). Tristar moves for summary judgment pursuant to Fed. R. Civ. P. 56(c) against defendants, who are defending this action *pro se*.

Background

Plaintiff Tristar was known as Ross Cosmetics from 1982 through 1993. (Rule 3(g) Statement at ¶ 1.) At the relevant time periods, defendants, in addition to being officers and directors of Ross Cosmetics, were each beneficial owners of more than 10 percent of the outstanding shares of the corporation. (Rule 3(g) Statement at ¶¶ 4-7, 9-11.) As insiders, defendants were indisputably subject to the reporting requirements of section 16(a), (Rule 3(g) Statement at ¶ 12), which places them within the scope of section 16(b), the statute which requires the disgorgement of insider short swing profits.

On May 31, 1989, when over 3 million shares of Ross Cosmetics were outstanding, defendants Freitas and Kenner entered into a binding contract, captioned "Periodic Loan Agreement" ("Loan Agreement"), to dispose of 906,594 shares of Ross Cosmetics common stock or approximately 28 percent of the outstanding shares. (Rule 3(g) Statement at ¶¶ 7-9.) Under the Loan Agreement, defendants agreed to transfer the Loan Agreement shares

("Agreement Shares") to Starion International Limited, a British Virgin Islands Corporation ("Starion"); for 577,120 of the Agreement Shares defendants were to receive a fixed price amounting to $7.50 per share. Pursuant to the Loan Agreement, payments for the Agreement Shares were characterized as "loan disbursements." The disbursements were to be transferred to defendants in sixteen installments at the $7.50 per share price according to the timetable and in the amount set forth in Schedule A and Schedule B. (Rule 3(g) Statement at ¶ 15.) An initial transfer of 60,868.00 shares for $283,310.62 at the share price of approximately $4.45 a share took place on the execution date of the agreement. (Loan Agreement at Schedules A and B.) Despite the installment feature of the Loan Agreement, it was "executed with the intention and belief . . . that it was and is to be performed in its entirety by the parties and was and is to be indivisible." (Loan Agreement at ¶ 10.1(i)).

In a series of transactions occurring between February 2, 1989 and June 15, 1989, defendants Freitas and Kenner purchased shares of Ross Cosmetics. (Rule 3(g) Statement at ¶¶ 28-29.) If the May 31, 1989 agreement was in fact a sale of the Agreement Shares, then defendants clearly purchased and sold shares within a six-month period. Defendants did not file Form 4 as required by section 16(a) until December 18, 1991. (Rule 3(g) Statement at ¶ 32.) Plaintiff brought this action on December 16, 1993.

The Court heard oral argument on this motion on November 4, 1994. As the Court noted, this motion presents two threshold legal issues: (1) whether the Loan

Agreement executed on May 31, 1989, although denominated a "loan agreement," actually constituted a binding "contract to sell or otherwise dispose of" shares for the purposes of section 16(b) and (2) whether plaintiff's motion is barred by the applicable statute of limitations.

Discussion

Standard of Review

Summary judgment should be granted only where there is "no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986). The moving party must demonstrate the absence of any genuine issue of material fact. *See Adickes v. Kress & Co.*, 398 U.S. 144, 157 (1970). Summary judgment is appropriate if, after drawing all reasonable inferences in favor of the party against whom summary judgment is sought, no reasonable trier of fact could find in favor of the non-moving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986).

The Statute

Section 16(b) provides, among other things, that when a statutory insider – that is, an officer or director who is required to file reports under section 16(a) – purchases and sells shares of covered equity securities

within a six-month period, the profit on those transactions is recoverable by the issuer.[1] The statute represents a congressional effort "to curb short-swing trading by insiders whose position gives them access to information not available to the investing public and the ability to influence corporate policy." *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 592 n.23 (1973) (citation omitted). Employing what is commonly referred to as a "crude rule of thumb," section 16(b) "is not aimed solely at the actuality of evil, or the veritable employment of inside information for purely speculative purposes, but also at potentiality for evil inherent in all insider short-swing trading." *Newmark v. RKO Gen., Inc.*, 425 F.2d 345, 350-351 (2d Cir. 1970) (citation omitted).

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[1] The statute provides in relevant part:

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) . . . or who is a director or an officer of the issuer of such security, . . . shall file with the Commission . . . a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month. . . .

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . .

15 U.S.C. § 78p(a)-(b).

Does the Loan Agreement constitute a section 16(b) "sale"?

The term "sale" is defined in the Act to include "any contract to sell or otherwise dispose of" shares. 15 U.S.C. § 78(c)(a)(14). In practice, this seemingly straightforward definition can be difficult to apply, although the definition does indicate that "something less than final execution and delivery of securities may constitute a sale." *Portnoy v. Revlon, Inc.*, 650 F.2d 895, 898 (7th Cir. 1981). *See also Kern County Land Co.*, 411 U.S. at 593 ("The statutory definitions of 'purchase' and 'sale' are broad and, at least arguably, reach many transactions not ordinarily deemed a sale or a purchase.") Given the complexities of modern financial transactions, it is often difficult, looking solely at the terms of the statute, to assess when, and whether, a 16(b) sale has occurred.

Since traditional cash-for-stock transactions clearly fall within the purview of the statute, with transactions of this type courts employ an objective approach, not looking beyond the statutory language. With "unorthodox" or "borderline" transactions, courts have developed an alternate approach, inquiring whether the particular type of transaction involved is one that gives rise to speculative abuse. *See Kern County Land Co.*, 411 U.S. at 593-595 (citations omitted); *see also Newmark*, 425 F.2d at 351 (citing *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967)). This "pragmatic" approach, "construing section 16(b) in a manner that seems most consistent with Congress' purpose," has been specifically affirmed and frequently utilized in the Second Circuit. *See, e.g., Mendell v. Gollust*, 909 F.2d 724, 728 (2d Cir. 1990) (citations omitted). As a general rule, a sale occurs when

"the insider has incurred an 'irrevocable liability' to dispose of the stock so that his 'rights and obligations' have become fixed." *Lewis v. Bradley*, 599 F. Supp. 327, 330 (S.D.N.Y. 1984) (citations omitted).

The Court has examined the Loan Agreement and finds that on May 31, 1989 defendants did in fact "contract to sell or otherwise dispose of" the Agreement Shares within the meaning of section 16(b). The Court is persuaded that the Loan Agreement has the ordinary indicia of an installment sales contract. On May 31, 1989, defendants deposited all the Agreement Shares into escrow and deposited into escrow proxies appointing Starion as true and rightful attorney and proxy for defendants. Whenever Starion provided a "loan disbursement" to defendants, the appropriate amount of shares were transferred out of escrow to Starion. Each time Starion paid an installment, Starion would receive another block of shares. Accordingly, the Court finds that the agreement was a sale for the purposes of section 16(b), and that defendants were contractually bound on May 31, 1989.[2] *See Blau v. Ogsbury*, 210 F.2d 426, 427 (2d Cir. 1954) (purchase occurred when defendant "incurred an irrevocable liability to take and pay for the stock. Thereafter for all speculative purposes he owned the stock.") *See also*

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[2] The Court also notes that even if the Court were to find that this was an "unorthodox" or "borderline" transaction – that is, one that was not obviously a sale – the appropriate analysis is whether the transaction involved is one that gives rise to speculative abuse. *See Kern County Land Co.*, 411 U.S. at 593-595 (citations omitted). It is clear that the May 31st transaction gives rise to the type of speculative abuse section 16(b) was designed to prohibit.

Stella v. Graham-Paige Motors Corp., 132 F. Supp. 100, 106 (S.D.N.Y. 1955) ("a contract for the sale of stock which the seller expected to fill by delivering stock which was subject to a pledge at the time of the making of the contract would result in a 'sale' as of that time rather than as of the date that the seller succeeded in redeeming it from the pledge"); SEA Rel. No. 18114 (Sept. 23, 1981, 46 Fed. Reg. 48147, at Q. 16) (stating that an insider who purchases securities under an installment agreement is deemed to have acquired beneficial ownership of such securities at the time he makes a firm commitment for its purchase). Defendants' argument that the sale was not binding on May 31, 1989 because it was still possible that Starion would breach the contract is rejected. A common-sense assessment of the mechanics of the Loan Agreement reveals that all of the Agreement Shares were committed on May 31, 1989.

Statute of Limitations Defense

Defendants' second argument is that plaintiff's action is barred by section 16(b)'s statute of limitations. Section 16(b) provides that no suit to recover short swing profits "shall be brought more than two years after the date such profit was realized." 15 U.S.C. § 78p(b). This suit was filed on December 16, 1993, the sale of shares occurred on May 31, 1989, and all of the relevant purchases occurred between February 2, 1989 and June 15, 1989. Accordingly, if there is no tolling with respect to section 16(b) claims, plaintiff's action is clearly untimely.

The Act is silent as to whether tolling of the two-years limitations period is permitted. Courts who have

confronted the issue have noted that the legislative history with respect to this provision is equally silent. *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 527-528 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981) (citing *Grossman v. Young*, 72 F. Supp. 375, 378 (S.D.N.Y. 1947)). There are essentially three possibilities with respect to section 16(b)'s limitations period: (1) that no tolling is allowed under the statute ("the strict interpretation"); (2) that the two-year period is tolled until the corporation had sufficient information to put it on notice of the alleged violation ("the notice or discovery interpretation"); and (3) that the two-year period is tolled until the insider files are requisite 16(a) reports ("the disclosure interpretation"). *Whittaker*, 639 F.2d at 527. *See also* Marc Steinberg and Daryl Landsdale, *The Judicial and Regulatory Constriction of Section 16(b) of the Securities Exchange Act of 1934*, 68 NOTRE DAME L. REV. 33, 55 (1992).

In *Whittaker*, the Ninth Circuit specifically adopted the "disclosure" interpretation, following the lead of several district courts in the Southern District of New York.[3] *See Whittaker*, 639 F.2d at 527-530; *Grossman*, 72 F. Supp. at 378; *Shattuck Denn Mining Corp. v. La Moret*, (1973-1974 Transfer Binder) CCH Fed.Sec.L.Rep. PP 94,429, at 95,472 (S.D.N.Y. 1974); *Blau v. Albert*, 157 F. Supp. 816, 819 (S.D.N.Y. 1947). This interpretation is eminently sensible: "[I]t would be a simple matter for the unscrupulous to

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[3] The Court rejects defendants' argument that the Ninth Circuit retreated from the *Whittaker* rule in *Kay v. Scientex Corporation*, 719 F.2d 1009 (9th Cir. 1983). The *Kay* case did not involve tolling, nor did the *Kay* Court give any indication that it was abandoning *Whittaker*. *See Kay*, 719 F.2d at 1014-15.

avoid the salutary effect of Section 16(b) which provides a remedy for the recovery of short term profits, simply by failing to file monthly reports in violation of subdivision (a) and thereby concealing from prospective plaintiffs the information they would need to adequately protect their interests. Such a construction would reward the violation of the statute and would manifestly frustrate congressional intent." *Whittaker*, 639 F.2d at 528 (quoting *Blau v. Albert*, 157 F. Supp. at 819) (other citation omitted).

Defendants urge the Court to adopt either the "strict interpretation" that no tolling is available or the "notice or discovery interpretation" which tolls the limitation period only until the corporation had sufficient information to put it on notice of the alleged violation. It is, after all, defendants repeated position that, even though the section 16(a) forms were not filed at the appropriate times, Starion clearly had knowledge of defendants' putative insider trades back in 1989.

Notwithstanding defendants arguments, the Court adopts the disclosure interpretation, an approach that is consistent with precedent, logic, and Congressional intent. Under this approach, since the complaint was filed within two years of defendants' belated filing of the forms required by section 16(a), the action is timely. Accordingly, defendants' statute of limitations defense is rejected.[4]

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[4] In the alternative, defendants contend that the disclosure interpretation cannot survive the Supreme Court's determination in *Lampf, Pleva, Lipkind, Prupis, & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2780 (1991) that tolling is inappropriate under section 10(b) of the Securities Act. In *Lampf*,

Calculation of Damages

Lowest Purchase Price, Highest Sales Price

In calculating the profit realized as a result of short swing stock profits, the appropriate method, laid down by the Second Circuit in 1943, is the "lowest price in, highest price out" method. *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). This approach has been unanimously affirmed in this circuit. Using this method, defendants' short swing profits were $101,004.00 for Freitas and $81,893.75 for Kenner.

Employment Contracts

Tristar argues that, since defendants' employment contracts ($44,436.00 for Freitas and $33,172.90 for Kenner) should be regarded as additional consideration for

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because section 10(b) is silent on the issue, the Supreme Court selected a one year from disclosure or three year from the conduct framework as the appropriate statute of limitations for section 10(b) violations. The Court then found that the one-year/three-year structure is incompatible with equitable tolling. The rationale underlying the *Lampf* decision is inapplicable to the section 16(b) context. Indeed, in *Lampf* the Supreme Court explicitly distinguished section 16(b) from the other securities statutes that had the one-year/three-year scheme. *Lampf*, 111 S. Ct. at 2780 n.5 ("Because [section 16(b)] requires the disgorgement of unlawful profits and differs in focus from section 10(b) and from the other express causes of action, we do not find Section 16(b) to be an appropriate source from which to borrow a limitations period here.") Certainly, *Lampf* does not preclude the Court from concluding that tolling is still available under section 16(b).

the sale of their shares, these figures should be considered part of the Court's computation of defendants' short swing profits. Defendants dispute that the employment contracts constitute additional short swing profits, stating that their duties and responsibilities remained unchanged by the Loan Agreement. In accordance with the Court's comments in open court, the Court finds that there is a material issue of fact as to whether the employment contracts constitute additional consideration for the sale of the Agreement Shares. Accordingly, on this point, plaintiff's motion for summary judgment is denied.

Pre-Judgment Interest

Plaintiff seeks prejudgment interest. Since section 16(b) is silent with respect to this issue, the award of prejudgment interest, although generally part of short swing profit recovery, is not mandatory. *Whittaker*, 639 F.2d at 533 (citation omitted). In a section 16(b) case, interest "is given in response to considerations of fairness. It is denied when its exaction would be inequitable." *Blau v. Lehman*, 368 U.S. 403, 414 (1962). In this case, considering the equities involved, pre-judgment interest is appropriate.

Conclusion

Defendants engaged in short swing transactions while they were insiders of Ross Cosmetics. Accordingly, plaintiff's motion for summary judgment for the recovery of the profits from those transactions is granted. With respect to the amounts sought by plaintiff corresponding to the payments due to the employment agreements,

there is an question of fact as to whether the employment contracts constitute additional consideration for the sale of the Agreement Shares. Accordingly, on this issue, plaintiff's motion for summary judgment is denied. In all other respects, plaintiff's motion is granted.

SO ORDERED.

Dated: Brooklyn, New York
November 9, 1994

/s/ Raymond J Dearie
RAYMOND J. DEARIE
United States
District Judge

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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TRISTAR CORPORATION,

Plaintiff,

- against -

ROSS A. FREITAS and
CAROLYN SAFER KENNER,

Defendants.

---------- x

CV-93-5722 (RJD)

ORDER AND FINAL JUDGMENT

WHEREAS, on November 9, 1994, the Court entered partial summary judgment on behalf of Plaintiff TRISTAR CORPORATION ("TRISTAR") in the amount of $101,004 against Defendant ROSS A. FREITAS ("FREITAS") and $81,893.75 against Defendant CAROLYN SAFER KENNER ("KENNER"), plus prejudgment interest from May 31, 1989;

WHEREAS, Plaintiff TRISTAR advised the Court that it withdraws any claim to additional amounts received by Defendants FREITAS and KENNER pursuant to two employment agreements entered into between Defendants and Ross Cosmetics Distribution Centers, Inc., dated May 31, 1989;

It is hereby **ORDERED, ADJUDGED, AND DECREED** that, Plaintiff TRISTAR shall have final judgment entered against Defendant FREITAS in the amount of $101,004, plus prejudgment interest from May 31, 1989, and against Defendant KENNER in the amount of $81,893.75, plus prejudgment interest from May 31, 1989

until the date hereof. Interest shall be calculated at a rate of nine percent (9%) per annum. Defendants FREITAS and KENNER shall be jointly and severally liable for these amounts.

/s/ Raymond J Dearie
HONORABLE
RAYMOND J. DEARIE
UNITED STATES
DISTRICT JUDGE
August 8, 1995

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 18th day of July one thousand nine hundred and ninety-six.

Tristar Corporation

Plaintiff-Appellee,

v Dkt No: 95-7952

Freitas

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellee Tristar Corporation.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED.**

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard

the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: /s/ Beth J. Meador
Beth J. Meador,
Administrative Attorney

Section 16 of the Securities Exchange Act of 1934

§ 78p. Directors, officers, and principal stockholders

(a) Filing of statement of all ownership of securities of issuer by owner of more than ten per centum of any class of security

Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) Profits from purchase and sale of security within six months

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

17 C.F.R. Section 240.16a-3

Rule 16a-3. Reporting Transactions and Holdings

(a) Initial statements of beneficial ownership of equity securities required by Section 16(a) of the Act shall be filed on Form 3. Statements of changes in beneficial ownership required by that Section shall be filed on Form 4. Annual statements shall be filed on Form 5. At the election of the reporting person, any transaction required to be reported on Form 5 may be reported on an earlier filed Form 4. All such statements shall be prepared and filed in accordance with the requirements of the applicable form.

(b) A person filing statements pursuant to Section 16(a) of the Act with respect to any class of equity securities registered pursuant to Section 12 of the Act need not file an additional statement on Form 3:

(1) When an additional class of equity securities of the same issuer becomes registered pursuant to section 12 of the Act; or

(2) When such person assumes a different or an additional relationship to the same issuer (for example, when an officer becomes a director).

(c) Any issuer that has equity securities listed on more than one national securities exchange may designate one exchange as the only exchange with which reports pursuant to Section 16(a) of the Act need be filed. Such designation shall be made in writing and shall be filed with the Commission and with each national securities exchange on which any equity security of the issuer is listed at the time of such election. The reporting person's obligation to file reports with each national securities exchange on which any equity security of the issuer is listed shall be satisfied by filing with the exchange so designated.

(d) Any person required to file a statement with respect to securities of a single issuer under both Section 16(a) of the Act and either Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(f) of the Investment Company Act of 1940 may file a single statement containing the required information, which will be deemed to be filed under both Acts.

(e) Any person required to file a statement under Section 16(a) of the Act shall, not later than the time the statement is transmitted for filing with the Commission, send or deliver a duplicate to the person designated by the issuer to receive such statements, or, in the absence of such a designation, to the issuer's corporate secretary or person performing equivalent functions.

(f) (1) A Form 5 shall be filed by every person who at any time during the issuer's fiscal year was subject to Section 16 of the Act with respect to such issuer, except as provided in paragraph (2) below. The Form shall be filed within 45 days after the issuer's fiscal year end, and shall disclose the following holdings and transactions not reported previously on Forms 3, 4 or 5:

(i) all transactions during the most recent fiscal year that were either exempt from Section 16(b) of the Act or constituted small acquisitions pursuant to § 240.16a-6(a);

(ii) all holdings and transactions that should have been reported during the most recent fiscal year, but were not; and

(iii) with respect to the first Form 5 requirement for a reporting person, all holdings and transactions that should have been reported in each of the issuer's last two fiscal years but were not, based on the reporting

person's reasonable belief in good faith in the completeness and accuracy of the information.

(2) Notwithstanding the above, no Form 5 shall be required where all transactions otherwise required to be reported on the Form 5 have been reported before the due date of the Form 5.

(g) All transactions shall be reported on Form 4, except as follows:

(1) Small acquisitions as specified in § 240.16a-6(a) shall be reported in the manner specified by that section;

(2) Exercises and conversions of derivative securities exempted pursuant to § 240.16b-6(b) shall be reported in the manner specified by § 240.16a-4; and

(3) Transactions that are exempted by operation of any rule pursuant to section 16(b) of the Act, other than exercises and conversions of derivative securities exempted pursuant to § 240.16b-6(b), shall be reported on either Form 5, or, at the option of the reporting person, Form 4, but in no event later than the due date of the Form 5 with respect to the fiscal year in which the transaction occurred.

(h) The date of filing with the Commission shall be the date of receipt by the Commission; *provided, however,* that a Form 3, 4, or 5 shall be deemed to have been timely filed if the filing person establishes that the Form had been transmitted timely to a third party company or governmental entity providing delivery services in the ordinary course of business, which guaranteed delivery of the filing to the Commission no later than the required filing date.

(i) Duplicated or facsimile versions of manual signatures of persons required to sign any document pursuant to Section 16 of the Act that is filed or

submitted to the Commission under the Act shall be considered manual signatures for purposes of the Act and rules and regulations thereunder; provided that, the original signed document is retained by the filer for a period of five years and, upon request, the filer furnishes to the Commission or the staff the original manually signed document.

William R. WHITTAKER, on behalf of himself, and executor of the estate of Beulah Whittaker, Plaintiff-Appellee,

v.

WHITTAKER CORPORATION, a California Corporation, Defendant-Appellant.

William R. WHITTAKER, on behalf of himself, and executor of the estate of Beulah Whittaker, Plaintiff-Appellant,

v.

WHITTAKER CORPORATION, a California Corporation, Defendant-Appellee.

Nos. 77-2297, 77-2550.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Oct. 4, 1979.

Decided Feb. 12, 1981.

Corporate insider, who paid amount of alleged short-swing profits to corporation on demand, brought action seeking declaratory judgment of nonliability and return of the monies previously paid. The United States District Court for the Central District of California, Laughlin E. Waters, J., found insider liable but also found that the statute of limitations operated to cut off his liability because of a specified date, and corporation appealed. The Court of Appeals, Tang, Circuit Judge, held that: (1) although securities in question were in insider's mother's name and profits realized from their trading went into her account, insider, who utilized his mother's assets as

his own pursuant to general power of attorney, was liable for short-swing profits; (2) trial court, in computing profits for purposes of determining liability under section of Securities Exchange Act governing short-swing profits, properly matched lowest purchase price with the highest sales price in any given six-month period; and (3) case would be remanded for consideration of the equities prior to determination as to whether to award prejudgment interest as part of recovery.

Affirmed in part; reversed and remanded.

Robert E. Cooper, Gibson, Dunn & Crutcher, Los Angeles, Cal., for defendant-appellant; Martin C. Washton, Los Angeles, Cal., on brief.

William T. Bisset, Hughes, Hubbard & Reed, Los Angeles, Cal., for plaintiff-appellee; William H. Levit, Jr., Los Angeles, Cal., on brief.

Appeal from the United States District Court for the Central District of California.

Before CHAMBERS and TANG, Circuit Judges, and ORRICK,* District Judge.

TANG, Circuit Judge:

This case involves liability under the insider short-swing trading provisions of the Securities Exchange Act of 1934, § 16, 15 U.S.C. § 78p. The principal questions

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* Honorable William H. Orrick, Jr., United States District Judge for the District of Northern California, sitting by designation.

presented are whether shares nominally owned by another may be attributed to an insider for liability under § 16(b) and whether the two-year limitations period of § 16(b) may be tolled. On demand by the Whittaker Corporation (Corporation), the putative insider, William Whittaker (William), paid the amount of alleged profits from insider transactions between December 1, 1965 and December 31, 1970 (the relevant trading period). He later sought a declaratory judgment of nonliability under § 16(b) and return of the monies previously paid. The district court found William liable but also found that the statute of limitations of § 16(b) operated to cut off liability for transactions prior to January 29, 1969. We affirm the district court on the issue of William's liability, but we reverse and remand on the limitations issue.

PRELIMINARY BACKGROUND

The Whittaker Corporation is a corporation in which William Whittaker and his mother, Beulah Whittaker, owned substantial percentages of stock. William was a director and Chairman of the Board of Directors during the relevant trading period. In 1965, because of amendments broadening § 16, the Corporation became subject to § 16 of the Securities Exchange Act of 1934, 15 U.S.C. § 78p (hereinafter § 16).

Briefly, § 16(a) requires "insiders" – any person who is a 10% beneficial owner of a company whose securities are registered under the Act or a director or an officer of the company – to file monthly reports with the Securities and Exchange Commission (SEC) showing any changes in the person's ownership in the company. Section 16(b)

declares that any profits which such person may realize by any purchase and sale of the company's securities within six months shall inure to and be recoverable by the company. Suits to recover such profits may be brought by the company or by any shareholder in a derivative suit if the company fails to do so. No such suit shall be brought more than two years after the date such profit was realized.

Since 1959 William had power of attorney from his mother Beulah to conduct business matters for her. The securities transactions involved in this case took place between December 1, 1965 and December 31, 1970. William purchased Whittaker Corporation common stock and convertible debentures for his mother's account, and within six months of such purchases, sold common stock for his own account and convertible debentures and common stock for his mother's account. None of the transactions involving securities for his mother's account were reported to the SEC as required by § 16(a). The district court determined that, because of the relationship between William and his mother, the control William had over her stock, and the benefits he realized from it, he must be deemed the beneficial owner of his mother's stock, and so should have reported the transactions under § 16(a) and was liable to the corporation under § 16(b) for profits derived from those transactions involving his mother's stock which he realized by a purchase and sale of the Corporation's securities within six months.

The Corporation asserts it did not learn of the full extent of William's total control over his mother's shares until the fall of 1970. It then compiled a list of all William's transactions in the securities of the Corporation,

determined which were six-month short-swing insider trades and computed the profit realized by William. In January 1971, the Corporation demanded payment of these realized profits plus interest.

On January 29, 1971, William paid the amount demanded, denied liability and reserved the right to bring an action to determine his liability and to seek return of the monies. William remained with the Corporation as President until November 1974 and as Chairman of the Board until January 31, 1975. On July 29, 1975, William and his mother commenced this action for a declaration of nonliability under § 16 and recovery of the money.

Trial was held before the court without a jury. The district court found that William was liable as an insider for the transactions in his mother's shares, but that the statute of limitations of § 16(b) barred recovery for all but one year of the relevant trading period. That is, only profits on transactions within two years prior to the Corporation's demand in January 1971 could be recovered. On the transactions for which the Corporation could recover, the district court computed profits realized according to the rule of "lowest price in, highest price out" within six months and awarded the Corporation prejudgment interest. The Corporation was then ordered to pay back the balance of the money paid in 1971.

ISSUES ON APPEAL

1. Was the Corporation's notice of appeal filed timely? (Raised by William on motion to dismiss)

2. Was William the beneficial owner of his mother's shares, so that profits realized in his transactions in those shares were "profits realized by him" for § 16(b) liability? (Raised by William on cross-appeal)

3. How should the two-year limitations period of § 16(b) be construed? (Raised by the Corporation on appeal)

4. Is the "highest sales price, lowest purchase price" method for computing profits in insider trading the correct method? (Raised by William on cross-appeal)

5. Was the award of prejudgment interest on the amount of profits recovered by the Corporation incorrectly decided by the district court? (Raised by William on cross-appeal)

I.

NOTICE OF APPEAL

William has moved to dismiss the Corporation's appeal on the ground that the notice of appeal was not timely filed. The judgment of the district court was entered on April 7, 1977. The judgment included the award of costs to the plaintiffs, William and Beulah Whittaker, as the prevailing party. On April 14, 1977 defendant Corporation moved to retax costs, specifically that all parties "bear their own taxable costs pending appeal of this action." The Corporation argued that it, not the plaintiffs, should be considered the prevailing party. The motion to retax costs was denied on April 20, 1977. Having learned that William would oppose any filing of a

notice of appeal as untimely on the ground that the 30-day period for filing under Fed.R.App.P. 4(a) had begun on April 7, 1977 and so had expired, the Corporation moved the district court for either 1) a determination that the motion to retax costs had extended the time for filing a notice of appeal since it was a Fed.R.Civ.P. 59(e) motion to alter or amend the judgment or 2) an extension of time for filing the notice of appeal by reason of "excusable neglect" in learning of the date of entry of judgment. The district judge rejected the excusable neglect contention but agreed the motion was a Rule 59(e) motion, even though it was denied. He ordered the Corporation's notice of appeal accepted for filing. It was filed May 18, 1977.

Failure to file a timely notice of appeal is jurisdictional; and the Court of Appeals would lack jurisdiction to review the judgment. *Browder v. Director, Department of Corrections*, 434 U.S. 257, 264, 98 S.Ct. 556, 561, 54 L.Ed.2d 521 (1978); *Rodriguez v. Southern Pacific Transportation Co.*, 587 F.2d 980, 981 (9th Cir. 1978); *Alexander v. Sacha*, 439 F.2d 742 (9th Cir. 1971). The notice of appeal must be filed within 30 days of the entry of judgment. Fed.R.App.P. 4(a). But the running of this time is terminated by a timely filed motion under, *inter alia*, Fed.R.Civ.P. 59(e) (motion to alter or amend the judgment), and the 30-day time commences anew from the date such motion is decided. The Corporation's motion was filed within the 10-day time limit for Rule 59(e) motions. Its notice of appeal was filed more than 30 days from the entry of judgment, but less than 30 days from the district court's denial of its motion to retax costs. The issue then is whether the Corporation's motion is a 59(e) motion

(which extends the time for appeal) or a Rule 54(d) motion which reviews the Clerk's actions regarding costs (which does not extend the time for appeal).

The Corporation styled its motion a motion to retax costs and did not recite that it was proceeding under Rule 59(e). "But nomenclature is not controlling." What is required is that the requested relief be "relief which might have been granted under Fed.R.Civ.P. 59(e)." *Sea Ranch Ass'n v. California Coastal Zone Conservation Comm'n*, 537 F.2d 1058, 1061 (9th Cir. 1976). *Accord Mir v. Fosburg*, Slip Op., at 1707, 646 F.2d 342, at 344 (9th Cir. 1980).

A motion to amend the judgment with respect to costs has been heard as a 59(e) motion where the motion was to tax costs against a different party, *United States v. Crawford*, 36 F.R.D. 174 (W.D.La.1964); or to delete the award of costs altogether, *United States v. 2,186.63 Acres of Land*, 464 F.2d 676, 677 (10th Cir. 1972); or to add costs where none were in the judgment before, *see Alameda v. Paraffine Companies, Inc.*, 169 F.2d 408, 409 (9th Cir. 1948) (prior to Rule 59(e), treating such motion as amending judgment so as to extend time for filing notice of appeal).[1]

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[1] Similarly, motions to reconsider the award of attorney's fees and motions to add attorney's fees to the judgment have been treated as Rule 59(e) motions. *See Hammond v. Public Finance Corp.*, 568 F.2d 1362 (5th Cir. 1978); *Stacy v. Williams*, 50 F.R.D. 52 (N.D.Miss.1970), *aff'd*, 446 F.2d 1366 (5th Cir. 1971); *Farmington Dowel Products Co. v. Forster Mfg. Co.*, 421 F.2d 61, 76 n. 39 (1st Cir. 1969). *Contra Lichtenstein v. Lichtenstein*, 55 F.R.D. 535, 537 (E.D.Pa.1972), *rev'd on other grounds*, 481 F.2d 682 (3d Cir. 1973), *cert. denied*, 414 U.S. 1144, 84 S.Ct. 895, 39 L.Ed.2d 98

On the other hand, Rule 54(d) motions are appropriate for correcting clerical errors in the bill of costs, disputing particular items or amounts, or otherwise amending an accepted award of costs. For substantive challenges as to the appropriateness of awarding costs at all, especially where such challenge involves a redetermination of who was the prevailing party, Rule 59(e) may be appropriate. We do not mean to imply that these categories are exclusive. It may be that some motions could be characterized as under both Rules 54(d) and 59(e) motion.

William relies on *Environmental Defense Fund, Inc. v. Froehlke*, 368 F.Supp. 231 (W.D.Mo.1973), *aff'd*, 497 F.2d 1340 (8th Cir. 1974). But in *Froehlke* the district judge found that the plaintiffs actually were seeking only a review of amount of costs and a determination of which costs were taxable to plaintiffs. 368 F.Supp. at 252-53. Moreover, the court appears to have been led to treat the motion as a 54(d) motion so as to reach the merits and avoid the untimeliness problem created if it were treated as a 59(e).[2]

(1974) (motion to amend judgment to add attorney's fees treated as 54(d) motion, not 59(e) motion, but done so in order to avoid dismissal of motion as untimely).

[2] *See* 368 F.Supp. at 253. William also relies extensively on *Knowles v. United States*, 260 F.2d 852 (5th Cir. 1958). But *Knowles* does not aid William. In *Knowles*, the plaintiff was disputing only two items of cost. Moreover, those costs had been levied on plaintiff by the district court in regard to a prior appeal of the case; they were not directly related to the judgment appealed from. Those costs were treated as a separate matter by both the district court and the Fifth Circuit. Finally, from the Fifth Circuit's opinion it is apparent neither that the motion to vacate

The Corporation's motion here was not a motion challenging any item of cost or amount of any item as assessed by the Clerk. Rather, it was a challenge as to who should be entitled to costs, that is, a question of who the prevailing party was. As the district judge recognized, because of the unusual procedural circumstances of this case, the roles of plaintiff and defendant were, in effect, reversed. Normally, the corporation would be the plaintiff, suing to recover the insider profit. Although William was technically the prevailing party since he won a money judgment, the Corporation had prevailed on the gravamen of its claim. If the suit had been a normal insider trading case, the Corporation would have "prevailed." Thus, the Corporation's motion went to the heart of how the judgment was to be characterized. The district judge is surely in a position to understand the ramifications of the motion on the judgment. *Cf. In re Estate of Butler's Tire & Battery Co., Inc.*, 592 F.2d 1028, 1032 (9th Cir. 1979) (district court's extension of time for appeal for excusable neglect under Fed.R.App.P. 4(a) overturned only for abuse of discretion). He thought the relief requested, if granted, "would have necessarily resulted in an amendment of that judgment."[3]

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these costs was made or treated as a Rule 59(e) motion nor that it was even timely filed as a Rule 59(e) motion with respect to the judgment Knowles sought to appeal. If it were not a *timely* Rule 59(e) motion, it could not have extended the time for appeal.

[3] The problem was only partly that the judgment as signed had expressly contained an award of costs to William. Even if that were not in the judgment, and the Clerk had merely awarded costs to William as a matter of course as the "prevailing party," a motion challenging the Clerk's action on the ground that the Corporation should be deemed the true

We agree and consider the Corporation's motion correctly construed as a Rule 59(e) motion. Since it was timely filed, it extended the time for filing the notice of appeal under Fed.R.App.P. 4(a). The Corporation's appeal is timely.

II.

BENEFICIAL OWNERSHIP AND PROFIT REALIZED

A. General Principles for § 16

Section 16(b) declares, in effect, that directors, officers, and 10% beneficial owners are presumed to have inside information and then states the corporation can recover any profits made by these insiders on transactions within a six-month period. This recovery rule is virtually automatic. Neither actual possession of inside information nor use of such information need be shown. Even initial good faith intent to hold the securities for longer than six months is no defense. "In short, this statute imposes liability without fault within its narrowly drawn limits." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 at 251, 96 S.Ct. 508 at 519, 46 L.Ed.2d 464. However, "it is an objective rule and does not reach every transaction in which an investor actually relies on inside information, or in which the potential for such reliance is great." *Lewis v. Varnes*, 505 F.2d 785, 787 (2d Cir. 1974). *See Blau v. Max Factor & Co.*, 342 F.2d 304, 307 (9th Cir.), *cert. denied*, 382 U.S. 892, 86 S.Ct. 180, 15 L.Ed.2d 150 (1965); *Rheem Mfg. Co. v. Rheem*, 295 F.2d 473,

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prevailing party would still be a Rule 59(e) motion insofar as it sought an interpretive amending of the judgment.

475 (9th Cir. 1961). *See generally* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1040-44.

In interpreting § 16 for situations which do not fall obviously within its scope, a certain tension is immanent [sic]. On the one hand, "where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 at 424, 92 S.Ct. 596 at 600, 30 L.Ed.2d 575. This "objective approach" goes back to the earliest cases interpreting the statute. "The statute is broadly remedial. . . . [I]t was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of (an insider) and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751, 64 S.Ct. 46, 88 L.Ed. 446 (1943). *See also Adler v. Klawans*, 267 F.2d 840, 846 (2d Cir. 1959) (§ 16 to be interpreted broadly so as to give full effect to plain congressional intent).

On the other hand, because of the mechanical application of § 16(b), imposing liability without fault on transactions within its scope, courts more recently have been hesitant to bring borderline transactions under that scope by interpretation where congressional intent was unclear and the transaction in question was not of a type giving rise to speculative abuse. *See, e.g., Foremost-McKesson, Inc.*, 423 U.S. at 252, 96 S.Ct. at 520 (person must be 10% owner prior to purchase at issue); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 at 593-95, 93 S.Ct. 1736 at 1744-1745, 36 L.Ed.2d 503 (sales

in context of blocked tender offer); *Reliance Electric Co.*, 404 U.S. at 424 n. 4, 92 S.Ct. at 600 n. 4 (person must be 10% owner at time of sale at issue); *Blau v. Max Factor & Co.*, 342 F.2d at 306-09; *Lewis v. Varnes*, 505 F.2d at 789; *Matas v. Siess*, 467 F.Supp. 217, 220-21, 224 (S.D.N.Y.1979).

Under this "subjective" or "pragmatic" approach, courts inquire whether the transaction involved carries a potential for insider abuse. Only those types of transactions which do are then found included within the statutory scope. *Kern County Land Co.*, 411 U.S. at 594-95, 93 S.Ct. at 1744-1745. However, the pragmatic approach has not ousted the objective view. Rather, the pragmatic approach is used to determine the boundaries of the statute's definitional scope in borderline situations, especially unorthodox transactions. *Id.* For a garden-variety transaction which cannot be regarded as unorthodox, the pragmatic approach is not applicable. *Mouldings, Inc. v. Potter*, 465 F.2d 1101, 1104-05 (5th Cir. 1972), *cert. denied*, 410 U.S. 929, 93 S.Ct. 1368, 35 L.Ed.2d 591 (1973); *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F.Supp. 1, 7 (S.D.N.Y.1980); *Matas v. Siess*, 467 F.Supp. at 220. In such cases, if the situation is within the requirements established by Congress for § 16, then the mechanical, "objective," operation of the statute imposes liability.

B. The Question Presented and Factual Background

Under § 16(b), the corporation may recover "any profit realized by him [the insider]" in covered short-swing transactions. In the present case, the securities in question were in William's mother's name and the profits realized in their trading went into her accounts. Thus, the

question arises whether these profits[4] were profits "realized *by him*" and so recoverable or were realized only by his mother and so not covered by § 16(b). William, relying on the narrow interpretive approach discussed above, argues that the term "by him" should be read strictly and narrowly and that, so read, it does not include the profits here. The Corporation and the district court below, however, use the concept of "beneficial ownership" in § 16(a) in order to give content to the term "realized by him" in § 16(b). Under that analysis William was found liable under § 16(b).

William raises his issues on cross-appeal as pure questions of law; he disputes none of the fact findings below. Accordingly, we accept and rely on the facts as found by the district court. In any event, the district court's findings of fact as to these issues are not clearly erroneous under Fed.R.Civ.P. 52(a). Pertaining to the ownership issue, the district court found the following.[5] In 1959, because of her advancing age, his mother granted William a broad general power of attorney, giving him the right to pay her bills, sign checks for her, manage her financial and business affairs, and purchase

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[4] More accurately, if the Corporation's position is correct and these securities are treated as William's, then profits would be computed by comparing purchases and sale of all the securities (both in Beulah's and William's names) and not merely comparing purchases and sales of those securities in the mother's name.

[5] This account is taken principally from pages 4-6 and 12-13 of the district court's unpublished opinion, *reprinted in* [1977-1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 96,008 at 91,528-29 & 91,531.

and sell securities for her investments. In 1969, this power was renewed. "At all times relevant to this litigation, Mr. Whittaker made and executed virtually all investment and business decisions for his mother on his own initiative and in his sole discretion pursuant to this power of attorney."

A joint bank checking account, bearing Beulah's and William's names, was set up for her expenses. From 1960 and throughout the relevant trading period, William maintained and personally signed all checks drawn on this joint account. During the same period, Beulah's income was deposited to this account and her expenses paid from it.

The district judge further found that "it is clear that Mr. Whittaker exercised virtually complete control over his mother's affairs. . . . " Throughout the relevant trading period, William received a series of substantial loans from his mother. His control over her finances enabled William "to freely borrow large sums of money from her while never having to consider paying the money back, posting adequate security or even paying any interest that might accrue." Moreover, William used his mother's assets to fund, through interest-free loans, advantageous investment opportunities he otherwise might have had to forego. William would borrow from a bank in his mother's name, and the interest would be paid from her funds.

As the district judge summarized, "(i)n short, the evidence indicates that Mr. Whittaker felt free to utilize his mother's assets exactly as if they were his own. It is thus obvious that Mr. Whittaker stood to gain on any

profits he might make for his mother through the purchase and sale of Whittaker Corporation securities."[6]

C. *"Profit realized by him"*

On this factual basis, the district court concluded that William was the "beneficial owner" of the securities under the definition of beneficial owner developed for § 16(a). Insiders must include in their reports required under § 16(a) those securities of which they are the "beneficial owner." *See* SEC Securities Exchange Act Release No. 7793 (Jan. 19, 1966) (discussed at page 526 *infra*). Under the applicable principles William was the beneficial owner and should have included them in his § 16(a) reports. This determination is uncontested. The district court then held that, if one is the beneficial owner, the securities are "his," and thus one must be chargeable with the profits under § 16(b), relying on *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975), *aff'g*, 386 F.Supp. 1130 (S.D.N.Y.1974), and on *Altamil Corp. v. Pryor*, 405 F.Supp. 1222 (S.D.Ind.1975).

William contends the district court was in error because *Blau v. Lehman*, 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), requires a narrow reading of "profits realized by him" in § 16(b) and particularly because the equation of "beneficial ownership" for § 16(a) reports with profit attribution for § 16(b) liability is erroneous as

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[6] The district court also noted that this was supported further by the fact that William was the sole beneficiary under his mother's will and would be her sole intestate heir, that she was of an advanced age and in poor health, and that it was unlikely that her will would be changed.

a matter of law. We reject William's contentions and affirm the district court on this issue. Our affirmance rests on two distinct grounds.

First, quite apart from any consideration of beneficial ownership, we hold that on the facts as found by the district court the profits are profits realized by William under § 16(b). William controlled his mother's investments. He thus controlled the trading in Corporation securities. He determined the timing and amount of sales and purchases. William had control over his mother's assets and so had control over money received for the Corporation securities. He could use those assets as freely as if they were his own. And in fact he did so use them, in large amounts, on several occasions. On these facts – control over the securities and unfettered ability to use the money for his own benefit – any reasonable interpretation of "profit realized by him" must encompass the instant case. *Cf. Mouldings, Inc. v. Potter,* 465 F.2d at 1103-05 (insider designated others to whom profits would go, profits held attributable to insider for § 16(b) liability).

Blau v. Lehman, 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), on which William relies principally, does not require a different result. In *Lehman,* Blau, a shareholder in Tide Water, brought a § 16(b) claim against Lehman Brothers, an investment banking house, and Thomas, a partner in Lehman Brothers and a director of Tide Water. While Thomas was a director of Tide Water, Lehman Brothers had engaged in short-swing trading of Tide Water stock for its own account and realized profits thereon. The Supreme Court held that all the Lehman

Brothers profits were not profits realized by Thomas personally and so Thomas was not liable for them under § 16(b). 368 U.S. at 413-14, 82 S.Ct. at 456-457.

William argues that, just as the Lehman profits were not attributable to Thomas, so his mother's profits are not attributable to him. William's reliance is misplaced. *Lehman* is clearly distinguishable. One partner in an investment firm has neither the same control over trading nor the same benefit from profits in the firm's portfolio that William had over his mother's securities. Indeed, several of the facts in *Lehman* underscore this distinction. Lehman Brothers purchased the Tide Water securities without consulting Thomas, and, once the purchases were discovered, Thomas was insulated from financial interest in them. *See* 368 U.S. at 406, 82 S.Ct. at 453. While it may have been "nothing but a fiction to say that Thomas 'realized' all the profits earned by the partnership of which he was a member," 368 U.S. at 414, 82 S.Ct. at 457, it would be an equal fiction here to say these profits are not William's.[7]

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[7] William also cites several cases in which other provisions of § 16(b) have been construed strictly and argues that "profits realized by him" must be similarly construed. *See Foremost-McKesson, Inc., supra; Kern County Land Co., supra; Reliance Electric Co., supra. See* page 10 *supra. See also Lewis v. Mellon Bank,* 513 F.2d 921 (3d Cir. 1975); *American Standard, Inc. v. Crane Co.,* 510 F.2d 1043 (2d Cir. 1974), *cert. denied,* 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975).

D. "Beneficial ownership" and "profit realized"

Our second rationale for affirmance involves consideration of the interrelationship between beneficial ownership in § 16(a) and profits realized by him in § 16(b). While we agree with the district court's result and also agree that there is a strong relationship between these provisions of § 16(a) and § 16(b), we do not agree that there is always an automatic equivalence between the two.

The intent and purpose of § 16 must be gleaned from the statute as a whole rather than from its isolated parts. *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). Sections 16(a) and 16(b) must also be read together because they are grammatically related. *See American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1058 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975). In particular, the scope and definition of insider or beneficial owner for § 16(b) has been determined by reference to § 16(a). *See Foremost-McKesson, Inc.*, 423 U.S. at 234 n.1, 96 S.Ct. at 511 n.1; *Kern County Land Co.*, 411 U.S. at 591 n.21, 93 S.Ct. at 1743 n.21; *Reliance Electric Co.*, 404 U.S. at 419 n.1, 92 S.Ct. at 597 n.1 (second paragraph). Under § 16(a), an insider is required to report changes in ownership of covered securities "of which he is the beneficial owner." Thus, for reporting purposes, stock ownership is attributed to directors and officers (as well as to principal – 10% – shareholders) by the concept of beneficial ownership. Moreover, the identity of some insiders (*i. e.*, those who are insiders by virtue of 10% beneficial ownership) for § 16(b) liability is determined by reference to § 16(a).

Thus, it is not far-fetched similarly to determine by reference to § 16(a) what stock those insiders own for § 16(b) liability.

The Second Circuit adopted this approach in a similar situation. In *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975), *aff'g* 386 F.Supp. 1130 (S.D.N.Y.1974), the court determined that a spouse's shares were beneficially owned by the insider and that once the insider is the " 'beneficial owner,' he must be chargeable with all the profits or none." *Whiting*, 523 F.2d at 689. In *Whiting* the shares were owned by the non-insider wife, and she had predominant control over them. However, analyzing all the facts, the court determined that the transactions were part of a jointly managed common investment plan, that the income was available to both spouses, and in particular that the proceeds of the sale of the wife's shares had been used to finance the husband's purchases. The court then concluded these facts made the husband the beneficial owner of these stocks under the SEC's definition of beneficial ownership. *See* SEC Securities Exchange Act Release No. 7793 (Jan. 19, 1966) ("Release 7793").[8]

Essentially, under Release 7793, a person is a beneficial owner of shares held in another's name if the person

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[8] SEC Release 7793 is reprinted in CCH Fed.Sec.L.Rep. ¶¶ 26,031 & 26,032. It appears in pertinent part in *Whiting*, 523 F.2d at 686 n.10. For general discussions of Release 7793, see 5 L. Loss, *Securities Regulation* (2d ed. Supp. 1969) at 3063-66; Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 Case Western Res.L.Rev. 1054 (1966).

either obtains benefits substantially equivalent to ownership or has the power to revest title in himself. However, Release 7793 defined beneficial ownership only for purposes of the § 16(a) reporting requirement. A subsequent SEC Release made it clear that the requirement to report beneficially owned shares was not coextensive with § 16(b) liability. SEC Securities Exchange Act Release No. 7824 (Feb. 14, 1966), *reprinted in* CCH Fed.Sec.L.Rep. ¶ 26,030 ("Release 7824"). Rather, liability under § 16(b) for transactions in beneficially owned shares is "to be determined by the facts of each particular case in an appropriate action brought by the issuer or its security holders." Release 7824. Under Release 7793, "a person ordinarily should include in his [§ 16(a) reports] securities held in the name of a spouse or minor children as being beneficially owned by him." It is this routine, automatic ("ordinarily") quality of § 16(a) reporting that makes the mere presence of a § 16(a) reporting requirement, without more, unsuitable as a conclusive determinant of § 16(b) liability.

The *Whiting* court recognized this limitation on § 16(a) beneficial ownership, 523 F.2d at 687, and further recognized the underlying reason for it – namely, that "[a] definition of 'beneficial ownership' may be broad enough to require reporting for purposes of public exposure but too broad for the imposition of liability under § 16(b)." 523 F.2d at 685 n.8. But, the *Whiting* court still ended with a general proposition that, if one is the "beneficial owner," one is chargeable with the profits. 523 F.2d at 689. The *Whiting* court apparently created an unexpressed new term, "beneficial ownership for § 16(b) purposes." The court then took the defining characteristics of

beneficial ownership in Release 7793 and applied them to the facts of the particular case, as Release 7824 advised. This application was done not simply to find if beneficial ownership for § 16(a) reporting was met, but to determine if the actual rewards of ownership were sufficiently present to warrant attributing the stock to the insider-spouse for § 16(b) liability. *See* 523 F.2d at 688-89. *See also* 386 F.Supp. 1130, 1136-38 (district court in *Whiting*). It was this "beneficial ownership for § 16(b)" which was dispositive in determining what profits were "realized by him."

The district court below, relying on *Whiting*, engaged in a similar reasoning. Analyzing the facts of William's control and benefit over the shares, the court concluded he "must be deemed the beneficial owner of [his mother's] securities for purposes of § 16(b)."

William argues the *Whiting* analysis equates § 16(a) reporting and § 16(b) liability and that such an equation unduly expands § 16(b). While the *Whiting* analysis is somewhat ambiguous, we do not read that case as making such an equation. Rather, the *Whiting* court engaged in a factual determination of beneficial ownership specifically for purposes of § 16(b). Nor, in following *Whiting*, did the district court in the case at bar make such an equation. The district court did not rely on the mere fact that his mother's shares were beneficially owned by William for § 16(a) reports. The court took evidence on the relation between his mother and William, the extent of William's involvement in managing her affairs, and particularly the degree of control William had over the Corporation securities, and the extent of his ability to enjoy the benefit therefrom. Only after evaluating this evidence

did the district court conclude that his mother's securities should be attributed to William in computing his profits realized under § 16(b).

In affirming the district court finding, we hold that an insider who trades in shares which he or she beneficially owns within the meaning of § 16(a) may be subject to the sanctions of § 16(b). Such liability should be imposed, however, only following a determination by the trial court not simply that the requirements of beneficial ownership were met for purposes of the § 16(a) reporting requirement, but that actual rewards of ownership were sufficiently present to warrant attributing the stock to the insider for purposes of § 16(b). In making this determination, the court should especially consider as key factors the degree to which the insider exercised control over the securities and the insider's ability to use the profits made. *See* Note, *"Beneficial Ownership" Under § 16(b) of the Securities Exchange Act of 1934*, 77 Colum.L.Rev. 446, 460-62 (1977).

William also contends that this analysis, like the *Whiting* court's, run contrary to the strict interpretive approach of the Supreme Court in *Foremost-McKesson, Inc.*, *Kern County Land Co.*, and *Reliance Electric Co.* Our reading of § 16(b) is not expansive. Moreover, in this instance, SEC Releases and an interrelationship between § 16(a) and § 16(b) are involved; the cited Supreme Court cases do not deal with interpretations in a similar context. Similarly, in the instant case, unorthodox transactions calling for the application of the pragmatic approach are not present. *See* discussion at pages 522-523 *supra*.

Our analysis, though approaching the issue through the theory of "beneficial ownership", arrives at the same conclusion as our analysis of whether "profits were realized" by William. *See* discussion at page 524 *supra*. Thus, the district court's finding of liability under § 16(b) must be affirmed.

III.

TWO YEAR LIMITATIONS PERIOD

A. Background

Section 16(b) provides that no suit under the section "shall be brought more than two years after the date such profit was realized." On demand by the Corporation, William paid the amount claimed on January 29, 1971. This date became the applicable date from which the statute of limitations is measured. If the two year period is applicable, then the Corporation is limited to recovery of profits realized only after January 29, 1969.

But how is the application of the two year time limit of § 16(b) to be construed? The parties present three theories of interpretation. First, William advances the "strict" interpretation under which the two years run strictly from the time the profits were realized, without any tolling. Second, there is a "notice" or "discovery" interpretation under which the time period is tolled until the Corporation had sufficient information to put it on notice of its potential § 16(b) claim. Finally, the Corporation advances the "disclosure" interpretation under

which the time period is tolled until the insider discloses the transactions at issue in his mandatory § 16(a) reports.[9]

The district judge hypothetically applied the notice interpretation. He found that various corporate officers had information which put the Corporation on notice throughout the relevant trading period. It was admitted that William did not disclose the transactions in his mother's shares on his § 16(a) reports as he was required to do. But the district court did not consider the disclosure interpretation separately, perhaps reasoning that actual notice would override any failure to report. Then, since tolling was not available, the district court determined it need not decide between the notice or strict interpretations.

On appeal, the Corporation renews its disclosure interpretation argument, and William renews the strict interpretation. Secondarily, accepting the notice interpretation, each side advances arguments that the facts do or do not support the district court's conclusion that the

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[9] There is also mention of a fraudulent concealment theory under which the time limit is tolled as long as the insider conceals the transactions from the Corporation. But as it has been used in the few prior § 16(b) cases, this is only a step in the analysis toward the disclosure interpretation. The failure to disclose in § 16(a) reports, whether intentional or inadvertent, is deemed concealment, thus triggering the traditional equitable tolling doctrine of fraudulent concealment. *See, e. g., Blau v. Albert*, 157 F.Supp. 816, 819 (S.D.N.Y.1957) (quoting Cook & Feldman, *Insider Trading under the Securities Exchange Act (Part I)*, 66 Harv.L.Rev. 385, 413 (1953)).

Corporation had notice. We hold the disclosure interpretation is the correct construction of § 16 and accordingly reverse the district court. Therefore, we need not reach the district court's conclusions based on the notice interpretation.

B. Tolling and the Reporting Requirement

The ultimate question is one of congressional intent, "whether tolling the limitation in a given context is consonant with the legislative scheme." *American Pipe and Construction Co. v. Utah,* 414 U.S. 538, 558, 94 S.Ct. 756, 768, 38 L.Ed.2d 713 (1974). Neither the mere fact that a statute creating a cause of action also contains a time limitation nor whether a time limitation is viewed as substantive or procedural forecloses the question of allowing or disallowing tolling; the determinative factor is whether tolling is not inconsistent with the legislative purpose. *See id.* at 556-59, 94 S.Ct. at 767-769.

The bare words of the time provision of § 16(b) do not say whether tolling is or is not allowed. Normally, we would turn to the legislative history. But the legislative history of § 16(b) is silent concerning this provision. *See Grossman v. Young,* 72 F.Supp. 375, 378 (S.D.N.Y.1947) (first case construing time provision of § 16(b)). However, examining the legislative purpose of § 16 as a whole and considering the place of the time provision in that overall legislative scheme, we infer that tolling of the two year time period is required when the pertinent § 16(a) reports are not filed.

The legislative history and purpose of § 16, discussed in Part II-A above, clearly reveal a strong congressional

intent to curb insider trading abuses. This purpose would be thwarted if insiders could escape liability by not reporting as required under § 16(a). "[I]t would be a simple matter for the unscrupulous to avoid the salutary effect of Section 16(b) which provides a remedy for the recovery of short term profits, simply by failing to file monthly reports in violation of subdivision (a) and thereby concealing from prospective plaintiffs the information they would need to adequately protect their interests. Such a construction would reward the violation of the statute and would manifestly frustrate congressional intent." *Blau v. Albert*, 157 F.Supp. 816, 819 (S.D.N.Y.1957). *Accord Grossman v. Young*, 72 F.Supp. at 378-79.

This conclusion is further supported by consideration of the complementary nature of § 16(a) and § 16(b). As subdivisions of the same section, they should be read together. *See, e. g., Foremost-McKesson, Inc.*, 423 U.S. at 234 n.1, 96 S.Ct. at 511 n.1; *American Standard Inc.*, 510 F.2d at 1058. *See also* discussion at pages 525-526 *supra*. The time limit is made a part of the section itself rather than incorporated by reference to another provision. The disclosures and reports of § 16(a) are an integral part of the context of § 16 within which § 16(b) must be read. The short limitations period is understandable only in the context of the insider's duty to make prompt disclosure. *See Grossman v. Young*, 72 F.Supp. at 378. "Effective operation of Section 16(b) is made possible by Section 16(a)'s requirement of full and prompt publicity. . . . " Note, *The Scope of "Purchase and Sale" Under Section 16(b) of the Exchange Act*, 59 Yale L.J. 510, 512 (1950).

Similarly, Congress' express provision in § 16(b) that individual security holders may bring suit on behalf of

the corporation to recover insider profits bolsters our interpretation. Even if other corporate officers or directors should know of an insider's transactions, this would not be the disclosure § 16 demands, because security holders can bring suit on the corporation's behalf. "Only by full compliance with Section 16(a) can the security holders be charged with adequate notice of the transaction." Cook & Feldman, *Insider Trading Under the Securities Exchange Act (Part I)*, 66 Harv.L.Rev. 385, 414 (1953). Such shareholders are likely to be outsiders, minority holders. Their main source of information for the suits Congress has empowered them to bring likely will be the required § 16(a) reports.[10] If insiders could insulate their transactions from the scrutiny of outside shareholders by failing to file § 16(a) reports and waiting for the two year time limit to pass, then Congress' creation of these shareholders' derivative suits would be nullified.

This congressional interest in affording individual security holders the opportunity to sue under § 16 militates in favor of the disclosure interpretation over the notice interpretation in another respect. Under the notice interpretation, the question arises whether the knowledge of corporate officers or directors should be attributed to the corporation, thus giving it notice and allowing the limitations period to run. Normally, knowledge of corporate officials is imputed to the corporation. But in the § 16

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[10] The reports are available to the public at the SEC and at the exchanges. 17 C.F.R. § 240.24b-3(a). The information in all the reports is compiled and published by the SEC in a pamphlet available at SEC offices and exchanges and widely distributed by subscription. See 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1039 & n.9.

context, if corporate officials' knowledge of another insider's trading and indeed even the trading insider's own knowledge were imputed to the corporation, then the corporation's right to recover the profits and especially the ability of minority shareholders to bring such suits would be seriously impaired. *Cf. Schur v. Salzman*, 365 F.Supp. 725, 733 (S.D.N.Y.1973); *Jefferson Lake Sulphur Co. v. Walet*, 104 F.Supp. 20, 23 (E.D.La.1952), *aff'd*, 202 F.2d 433 (5th Cir.), *cert. denied*, 346 U.S. 820, 74 S.Ct. 35, 98 L.Ed. 346 (1953) (corporation's § 16(b) suit not estopped on ground that corporation approved of transactions, since corporation's action under control of very insiders involved). *See also* Cook & Feldman, *supra*, 66 Harv.L.Rev. at 413-14. Collusion among insiders and, a more likely occurrence, the unarticulated acquiescence in or averting of gaze from a powerful insider's transactions thus would be rewarded under the notice interpretation. This problem does not arise under the disclosure interpretation. Thus, the disclosure interpretation adopted herein better serves the purposes of the statute.

Finally, the purpose of § 16 to impose absolute accountability within clearly demarcated boundaries, supports the disclosure interpretation. This goal of clear boundaries is served by a limitations period which can be mechanically calculated from objective facts. The dates on which purchases and sales are made are such facts, as are the dates on which § 16(a) reports are filed with the SEC. By contrast, under the notice interpretation, the running of the limitations period would depend on uncertain determinations of what knowledge should lead a corporation to discover its cause of action. Thus, the disclosure

interpretation better serves the statute's purpose than the notice interpretation.

C. *Statutory Analysis and Prior Cases*

Only a few cases have considered the two year limitation provision of § 16(b). Three cases from the Southern District of New York agree with our analysis. *See Shattuck Denn Mining Corp. v. La Morte,* [1973-74 Transfer Binder] CCH Fed.Sec.L.Rep. ¶¶ 94,429, at 95,472 (S.D.N.Y.1974). *Blau v. Albert,* 157 F.Supp. 816 (S.D.N.Y.1957); *Grossman v. Young,* 72 F.Supp. 375 (S.D.N.Y.1947). One case from the Middle District of Pennsylvania rejected this analysis and adopted a strict interpretation of the two year limit. *See Carr-Consolidated Biscuit Co. v. Moore,* 125 F.Supp. 423 (M.D.Pa.1954).[11] *Grossman v. Young* and *Blau v. Albert* are the better reasoned decisions, and reference is made to them for more elaboration of the disclosure interpretation. *See also* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1055-58 (discussing the two year limitation, approving *Grossman,* and critizing *Carr-Consolidated Biscuit Co.*).

The court in *Carr-Consolidated Biscuit Co.* relied on the discarded theory that substantive statutes of limitation

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[11] In four other cases, the two year limit, strictly calculated, was held to bar suit or was assumed to be the measure, but in these cases the question of tolling due to failure to file § 16(a) reports was not presented. *See Morales v. Mylan Laboratories, Inc.,* 443 F.Supp. 778 (W.D.Pa.1978); *Cowsar v. Regional Recreations, Inc.,* 65 F.R.D. 394 (M.D.La.1974); *Chambliss v. Coca-Cola Bottling Corp.,* 274 F.Supp. 401 (E.D.Tenn.1967), *aff'd,* 414 F.2d 256 (6th Cir. 1969), *cert. denied,* 397 U.S. 916, 90 S.Ct. 921, 25 L.Ed.2d 97 (1970); *Blau v. Lamb,* 191 F.Supp. 906 (S.D.N.Y.1961).

are entitled to literal application by the courts and may not be tolled. *See* 125 F.Supp. at 429-30. But this theory was effectively renounced by the Supreme Court in *American Pipe and Construction Co. v. Utah*, 414 U.S. 538, 556-59, 94 S.Ct. 756, 767-769, 38 L.Ed.2d 713 (1974). The *Carr-Consolidated Biscuit Co.*, court also relied on a comparison of the limitation provision in § 16(b) with those in other securities statutes – for example, §§ 9(e) and 18(c) of the 1934 Act, 15 U.S.C. §§ 78i(e) and 78r(c), and § 13 of the 1933 Act, 15 U.S.C. § 77m. See 125 F.Supp. at 430-31. In those statutes, Congress expressly provided for the operation of limitations periods in other than a strict manner. The court surmised that the absence of an express provision for tolling in § 16(b) necessarily shows congressional intent of a strict interpretation. Urging the strict interpretation, William renews this comparison of statutory provisions argument, citing recent Supreme Court cases in other securities areas using such an analysis. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206-09, 96 S.Ct. 1375, 1387-1388, 47 L.Ed.2d 668 (1976) (various standard-of-liability provisions of the 1934 Act must be read together); *Blue Chip Stamps v. Manor Drugs Stores*, 421 U.S. 723, 733-36, 95 S.Ct. 1917, 1924-1926, 44 L.Ed.2d 539 (1975) (various standing-to-sue provisions of the 1934 Act must be read together).

As an approach to statutory construction, this comparative analysis is obviously sound. In this instance, however, the comparison is not so helpful to William's position. First, the light those other provisions may shed on § 16(b) by comparison depends on the clarity of the other provisions in their own right. But the meaning of the other provisions of the 1934 Act, §§ 9(e) and 18(c), is

not clear. *See, e. g., Jacobson v. Peat, Marwick, Mitchell & Co.*, 445 F.Supp. 518, 526-27 (S.D.N.Y.1977) (construing "accrued" in § 18(c)).

Furthermore, the provisions actually appear silent on the question of tolling. They each create a three year limitations period from the time the action accrues but make an additional, shorter limit of one year from actual discovery of the facts constituting the action. Indeed, these provisions appear to have a meaning contrary to that advanced by William and *Carr-Consolidated Biscuit Co.* William argues these provisions expressly provide for tolling and therefore the absence of similar congressional expression in § 16(b) is revelatory. But, on their face, these provisions appear provide an absolute three-year maximum, beyond which suit may not be brought regardless of when the facts are discovered. *See, e. g., Bader v. Fleschner,* 463 F.Supp. 976, 981 (S.D.N.Y.1978). Thus, the absence of similar language creating a maximum time limit in § 16(b) shows that Congress contemplated tolling in appropriate circumstances in § 16(b) cases. We do not decide whether this interpretation of §§ 9(e) and 18(c) is correct. It merely shows that the comparative analysis argument advanced by William is unpersuasive.

Moreover, even if the comparison of § 16(b) with the other provisions were more favorable to William's position, the comparison of statutory provisions analysis would not be complete until the language of § 16(b)'s limitation provision had been considered in light of the context of all of § 16. As discussed earlier, § 16(b) is interrelated with the congressionally created reporting requirements of § 16(a). Sections 9(e) and 18(c) do not have similar disclosure provisions. Therefore, comparison

with them is unhelpful in determining how a disclosure provision interacts with a limitations period.

In summary, we hold that an insider's failure to disclose covered transactions in the required § 16(a) reports tolls the two year limitations period for suits under § 16(b) to recover profits connected with such a non-disclosed transaction.[12] The two-year period for § 16(b) begins to run when the transactions are disclosed in the insider's § 16(a) report. See *Blau v. Albert*, 157 F.Supp. at 819; *Shattuck Denn Mining Corp. v. La Morte, supra*. This interpretation is consistent with the legislative scheme of § 16. It is supported by prior cases construing the section and by securities commentators. The district court's result on the limitations issue is therefore reversed.

IV.

PROFIT COMPUTATION METHOD

In calculating the profit realized as a result of William's securities transactions the district court used the "lowest purchase price, highest sale price" method. This method was set forth long ago by the Second Circuit in *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751, 64 S.Ct. 56, 88 L.Ed. 446 (1943). Courts appear nearly unanimous in approving the

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[12] We note that the American Law Institute's proposed Federal Securities Code expressly provides for tolling in insider liability recovery while there is violation of the reporting requirement. *See Federal Securities Code* (Proposed Official Draft, March 15, 1978) §§ 605(a) (reporting requirements), 1717 (insider liability), & 1727(d) (statute of limitations and tolling).

Smolowe rule; commentators are also generally in favor, but there are some critics. *See* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1062-65; 5 L. Loss, *Securities Regulation* (2d ed. Supp.1969) at 3024-25; Cook & Feldman, *Insider Trading Under the Securities Exchange Act (Part II)*, 66 Harv.L.Rev. 612, 612-14 (1953). The question of the profit computation method for § 16(b) is one of first impression in this circuit. The Corporation urges that we adopt the long-standing *Smolowe* rule. William argues the *Smolowe* rule is incorrect and proposes a rule matching sales with purchases closest in time. Persuaded by its merit and its long continued use in other courts, we adopt the *Smolowe* rule.

Under the *Smolowe* rule, the highest sales price is matched with the lowest purchase price in any given six month period.[13] In analyzing the legislative history and the remedial nature of the statute, the court in *Smolowe* concluded:

> The statute is broadly remedial. [citation omitted] Recovery runs not to the shareholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder

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[13] The operation if the *Smolowe* rule is explained at, *e. g.*, 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1063 (quoting Rubin & Feldman, *Statutory Inhibitions upon Unfair Use of Corporate Information by Insiders*, 95 U.Pa.L.Rev. 468, 482-83 (1947)).

> and the faithful performance of his duty. [citations omitted] The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out – within six months.

Smolowe, 136 F.2d at 239. Eight years later the Second Circuit again considered the profit computation issue and, after an independent analysis, affirmatively reasserted the *Smolowe* doctrine. *Gratz v. Claughton,* 187 F.2d 46, 50-52 (2d Cir.), *cert. denied,* 341 U.S. 920, 71 S.Ct. 741, 95 L.Ed. 1353 (1951) (L. Hand, J.).

The Second Circuit continues to adhere to the *Smolowe* rule. *See Feder v. Martin Marietta Corp.,* 406 F.2d 260, 269 (2d Cir. 1969), *cert. denied,* 396 U.S. 1036, 90 S.Ct. 678, 24 L.Ed.2d 281 (1970); *Adler v. Klawans,* 267 F.2d 840, 847-48 (2d Cir. 1959). *Cf. Cummings v. Commissioner,* 506 F.2d 449, 452 (2d Cir. 1974), *cert. denied,* 421 U.S. 913, 95 S.Ct. 1571, 43 L.Ed.2d 779 (1975) (in analysis that insider's repayment of § 16(b) profits is a long term capital loss, court uses *Smolowe* approvingly).

The large majority of profit computation cases expectably are in the Second Circuit and, particularly, in the Southern District of New York. A long series of district court cases there have continued to apply the *Smolowe* rule. *See, e. g., Lewis v. Levinson,* [1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 96,430 (S.D.N.Y.1978); *Makofsky v. Ultra Dynamics Corp.,* 383 F.Supp. 631, 638-39 (S.D.N.Y.1974); *Schur v. Salzman,* 365 F.Supp. 725, 730-31 (S.D.N.Y.1973); *Volk v. Zlotoff,* 318 F.Supp. 864, 865 (S.D.N.Y.1970).

When the question of profit computation in § 16(b) has arisen in other courts, they too have adopted the *Smolowe* rule of lowest price in, highest price out. *See Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 742-43 (8th Cir. 1965), *cert. denied*, 382 U.S. 987, 86 S.Ct. 556, 15 L.Ed.2d 475 (1966); *Morales v. Mylan Laboratories, Inc.*, 443 F.Supp. 778, 780 (W.D.Pa.1978); *Heli-Coil Corp. v. Webster*, 222 F.Supp. 831, 837 (D.N.J.1963), *aff'd as modified on other grounds*, 352 F.2d 156 (3d Cir. 1965); *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.*, 141 F.Supp. 841, 847 (W.D.Ark.1956). *See also Ohio Drill & Tool Co. v. Johnson*, 498 F.2d 186, 194-95 (6th Cir. 1974) (directing *Smolowe* rule be used in profit computation under state insider trading statute).

William cites one case as disapproving the *Smolowe* rule, namely, *Allis-Chalmers Manufacturing Co. v. Gulf & Western Industries, Inc.*, 527 F.2d 335 (7th Cir. 1975), *cert. denied*, 423 U.S. 1078, 96 S.Ct. 865, 47 L.Ed.2d 89 (1976). In *Allis-Chalmers*, the Seventh Circuit declined to apply the *Smolowe* rule in the case before it. But the court in *Allis-Chalmers* did not reject the *Smolowe* rule; indeed it "agree[d] with the underlying principle of the . . . *Smolowe* case." 527 F.2d at 355. The court distinguished its case from *Smolowe* on the ground that *Smolowe* involved the problem of trade-matching. There were multiple sales and purchases, and some rule had to be adopted to determine how they should be matched for computing profit. But *Allis-Chalmers* involved a question of valuation of the shares and was not a trade-matching case, and so the court did not apply the *Smolowe* rule. *See* 527 F.2d at 354-56. *Cf. Anderson v. Commissioner*, 480 F.2d 1304, 1307 (7th Cir. 1973) (in holding insider's repayment

of § 16(b) profits a long term capital loss, Seventh Circuit approvingly cites *Smolowe* rule).

William also maintains the *Smolowe* rule is inconsistent with the legislative history of § 16(b). That the *Smolowe* rule serves the legislative purpose of § 16(b) is amply demonstrated in the previously discussed Second Circuit cases. William's principal argument is a comparison of the original version of § 16(b) with the final result. The original Senate and House versions of what became § 16(b) provided for a variation of the "lowest in, highest out" method of profit calculation.[14] This language did not appear in the final version enacted into law. William argues this shows congressional rejection of such a method of profit calculation and it is thus improper for the courts to resurrect it.

This argument is without substance. As William concedes in his brief, there is no statement anywhere in the legislative history as to why this language did not appear in the final version. There is no intimation that Congress

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[14] The pertinent language of the earlier bills provided as follows:

> For the purposes of this subsection the profit shall be calculated on the sale or sales by such person of such security made at the highest price or prices and on the purchase or purchases made by such person of such security at the lowest price or prices during the six months' period, irrespective of the certificates for such security received or delivered to such person during such period.

S. 2693, H.R. 7852, 73d Cong., 2d Sess. § 15(b) (1934), *reprinted in* Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (Ellenberger & Mahar ed. 1973).

disapproved of it. William's characterization of what occurred as "congressional rejection" is extreme. If Congress had deleted this language and replaced it with other language describing another method of profit calculation, one might infer that Congress disapproved of the prior language. *Cf. National Automatic Laundry and Cleaning Council v. Shultz*, 443 F.2d 689, 706 (D.C.Cir. 1971) (positive congressional action in rejecting amendments, unlike mere inaction, carries some weight). But all that occurred here is that certain language did not appear in the final version. Statutory interpretation cannot rest safely on mere inaction in Congress; nor can it rest on unexplained changes made in congressional committees. *Federal Trade Commission v. Dean Foods Co.*, 384 U.S. 597, 609-10 & n. 11, 86 S.Ct. 1738, 1745 & n. 11, 16 L.Ed.2d 802 (1966); *Trailmobile Co. v. Whirls*, 331 U.S. 40, 61, 67 S.Ct. 982, 992, 91 L.Ed. 1328 (1947); *United Sates* [sic] *v. Imperial Irrigation District*, 559 F.2d 509, 535-36 (9th Cir. 1977), *rev'd on other grounds sub nom. Bryant v. Yellen*, 447 U.S. 352, 100 S.Ct. 2232, 65 L.Ed.2d 184 (1980). Legislative silence cannot be viewed as an expression of congressional intent. Without some indication in the legislative history of the reasons why this change occurred, it is unwise to infer much from the silence of Congress. *Cf. Scripps-Howard Radio, Inc. v. Federal Communications Commission*, 316 U.S. 4, 11, 62 S.Ct. 875, 86 L.Ed. 1229 (1942) (search for significance in Congress' silence is often the pursuit of a mirage).

Also persuasive is the fact that in the over thirty-five years since *Smolowe* was decided and has been applied, Congress has failed to act to set aside the rule through contrary legislation. We believe the *Smolowe* rule is in

accord with the absolute and thoroughgoing nature of liability under § 16(b). This statute is intended to be a deterrent to a type of activity which Congress realized was subject to much abuse. In some cases the *Smolowe* rule can be criticized for harshness and artificiality. But other methods would be equally artificial.[15] The *Smolowe* rule assures full recovery of profits for the corporation. The *Smolowe* rule of matching the lowest purchase price and highest sale price within six months serves the purpose of § 16(b). Following the unbroken acceptance of this method by other courts, we adopt it as the rule in this circuit. The district court is affirmed on this issue.

V.

PREJUDGMENT INTEREST

Although § 16 says nothing about the recovery of interest one way or the other, prejudgment interest is generally considered a part of § 16(b) recovery. However, its award is not mandatory. *See generally* 5 L. Loss, *Securities Regulation* (2d ed. Supp. 1969) at 3025-27. The allowance of interest is within the discretion of the trial court, but "the granting of such allowance should not follow as a matter of course." *Gold v. Sloan*, 486 F.2d 340, 353 (4th Cir. 1973), *cert. denied*, 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 112 (1974). Rather, in a § 16(b) case interest "is

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[15] William urges a rule whereby purchases are matched against the immediately preceding or immediately following sales, whichever is higher. A similar proposal, that the matching of shares be on a last in-first out basis, was rejected in *Lewis v. Levinson*, [1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 96,430 (S.D.N.Y.1978).

given in response to considerations of fairness. It is denied when its exaction would be inequitable." *Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962). "Whether interest will be awarded is a question of fairness, lying within the court's sound discretion, to be answered by balancing the equities." *Wessel v. Buhler*, 437 F.2d 279, 284 (9th Cir. 1971) (10b-5 case). *Accord Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d at 744 (§ 16(b) case). A reviewing court will upset the district court's decision granting or denying prejudgment interest only if it is so unfair or so inequitable as to require it. *Blau v. Lehman, supra ; Blau v. Lamb*, 363 F.2d 507, 528 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed.2d 542 (1967).

Among the factors to be considered in weighing the equities is whether the insider acted innocently or knowingly. In many cases, interest has been denied where it was shown the insider acted in good faith. *See, e. g., Gold v. Sloan, supra; Oliff v. Exchange International Corp.*, 449 F.Supp. 1277, 1302 (N.D.Ill.1978); *Morales v. Gould Investors Trust*, 445 F.Supp. 1144, 1156 (S.D.N.Y.1977), *aff'd without opinion*, 578 F.2d 1369 (2d Cir. 1978); *Volk v. Zlotoff*, 318 F.Supp. 864, 867 (S.D.N.Y.1970); *Marquette Cement Mfg. Co. v. Andreas*, 239 F.Supp. 962, 968 (S.D.N.Y.1965).

These cases do not mandate a requirement of bad faith or willful violation for the award of prejudgment interest; rather, they justify its denial when such factors are absent. In the balancing of equities in these cases, it is not a one-dimensional question of subjective good or bad faith. The type and degree of the insider's inadvertence, the position of the insider in the corporation, and other circumstances of each case are considered. Even when

bad faith may have been absent, interest is still sometimes awarded. *See Champion Home Builders Co. v. Jeffress*, 385 F.Supp. 245, 250 (E.D.Mich.1974); *Perfect Photo, Inc. v. Grabb*, 205 F.Supp. 569, 573-74 (E.D.Pa.1962). *See also Magida v. Continental Can Co.*, 231 F.2d 843, 848 (2d Cir.), *cert. denied*, 351 U.S. 972, 76 S.Ct. 1031, 100 L.Ed. 1490 (1956). *Cf. B. T. Babbitt, Inc. v. Lachner*, 332 F.2d 255, 259 (2d Cir. 1964) (interest awarded without discussion). The insider must show there is an overriding inequity in allowing interest in order to overcome the granting of interest. *Western Auto Supply Co.*, 348 F.2d at 744. The insider's good faith must be shown; bare allegations are not sufficient. *Gold v. Sloan*, 486 F.2d at 353; *Lewis v. Realty Equities Corp.*, 396 F.Supp. 1026, 1034 (S.D.N.Y.1975).

When an insider repays the corporation promptly upon demand, that has been taken as betokening good faith and justifying denial of interest, especially when the prompt repayment means the corporation has not lost use of the money for a long time. *See Abbe v. Goss*, 411 F.Supp. 923, 926 (S.D.N.Y.1975); *Lewis v. Wells*, 325 F.Supp. 382, 387 (S.D.N.Y.1971).

Another factor in balancing the equities is the length of time involved. When there has been substantial delay between transactions and complaint or between complaint and judgment, courts consider who was responsible for the delay an important factor in allowing interest for such periods. *See Gold v. Sloan, supra; Lewis v. Realty Equities Corp.*, 396 F.Supp. at 1035; *Schur v. Salzman*, 365 F.Supp. 725, 734-35 (S.D.N.Y.1973); *Blau v. Lamb*, 242 F.Supp. 151, 161 (S.D.N.Y.1965), *aff'd*, 363 F.2d 507, 528 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed.2d 542 (1967). Moreover, a delay can also be a factor

in establishing the date from which interest accrues. Normally, interest accrues from the time of the transactions. *See, e. g., Western Auto Supply Co.*, 348 F.2d at 744. But where delay has occurred for which the insider was not responsible, in accommodating the equities some courts have awarded interest to run from the commencement of suit. *See Champion Home Builders Co.*, 385 F.Supp. at 250; *Schur, supra.* In *Schur* the court particularly distinguished between the pre-complaint delay for which the plaintiff was responsible and the delaying litigation tactics for which the insider defendant was responsible.

In the case at bar, the district court awarded prejudgment interest on the profits recoverable, *i. e.*, those not barred by the district court's ruling on the limitations issue. William argues the district court erroneously applied an absolute rule granting interest instead of weighing the equities. The use of an absolute rule without regard to the equities would be incorrect. But it is not apparent that the district court used an absolute rule. The lower court's opinion on this point may reflect a decision that, after considering the circumstances of this case, the equities did not tip in favor of departing from the usual objective nature of § 16(b) liability.

But we need not decide this today. Our decisions on liability and the limitations period may result in a larger amount of profit recovery and a longer period of liability. This may have an effect on the balance of equities. Thus we remand the question of prejudgment interest to the district court for reconsideration in light of the foregoing principles. *See Thomas v. Duralite Co., Inc.*, 524 F.2d 577, 589 (3d Cir. 1975) (similar remand of prejudgment interest

in 10b-5 case). We express no opinion on whether prejudgment interest is appropriate here. The balancing of equities on the award of interest must be done in light of all the facts and circumstances of the case. In the first instance, that determination is left to the discretion of the district court.

CONCLUSION

We hold today that William is liable under § 16(b) for profits realized in transactions connected with William's trading of shares held in his mother's name. In this result we agree with the district court. However, we also hold that the two-year limitations period of § 16(b) is tolled as long as the insider has not disclosed the transactions on the required § 16(a) reports. Thus, since reports of the transactions in question here were not filed, William's liability is not cut off by the limitation period. We reverse the district court in this regard. Further, we agree with the district court that the *Smolowe* rule for trade-matching to calculate profits is correct. Finally, we remand the award of prejudgment interest to the district court for reconsideration.

AFFIRMED in part; REVERSED and REMANDED for proceedings in accordance with this opinion.

Supreme Court, U.S.
FILED
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(2)

No. 96-577

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1996

TRISTAR CORPORATION,

Petitioner,

v.

ROSS A. FREITAS and CAROLYN SAFER KENNER,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS

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CORRECT DENOMINATION OF NAMES

Respondents, defendants below, are Ross A. Freitas and Carolyn Safer Kenner (incorrectly spelled *Caroline* Safer Kenner on the cover of Petitioner's petition).

Each of the respondents join in this brief in opposition.

Respondents' attorneys below (following Respondents' pro-se representation) were Caro & Graifman, P.C., by Chase A. Caro and Brian D. Graifman (incorrectly denominated by Petitioner, *compare* Pet. App. 2 *with* 84 F.3d 550, 551 (2d Cir.), *reh'g denied* (1996)).

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COUNTER-STATEMENT OF THE CASE

A. Section 16

Section 16(b) of the Securities Exchange Act permits a shareholder or issuer to maintain action against any director, officer or beneficial owner of more than 10% of any class of outstanding shares (a "statutory insider") who profits from short-swing transactions in that corporation's securities. 15 U.S.C. 78p(b). A short-swing transaction is "any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months." *Id.* A suit to recover such profits may be brought "by the issuer, or by the owner of any security of the issuer . . . in behalf of the issuer . . . ; *but no such suit shall be brought more than two years after the date such profit was realized.*" *Id.* (emphasis added).

Section 16(a) provides a mechanism for facilitating the recovery of short-swing profits by requiring statutory insiders to disclose any change in ownership "within ten days after the close of each calendar month" in which such change occurs. *Id.* § 78p(a). That disclosure is made via a Form 4 or Form 5 (filed with the Commission and made publicly available). The corporation or shareholder may then use the Forms to establish liability in an action under section 16(b). Because the "statute imposes liability without fault within its narrowly drawn limits," *Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 251 (1976), recovery in such actions "is virtually automatic." *Whittaker v. Whittaker Corp,* 639 F. 2d 516, 522 (9th Cir.), *cert. denied,* 454 U.S. 1031 (1981).

Section 16(b), instituted as a strict liability provision, is necessarily arbitrary. Accordingly, fraudulent minded

insiders are treated identically to those with the best intentions. However, unlike most provisions in the Exchange Act, section 16(b) is not a criminal provision. It does not make short-swing trading illegal. Instead, the section merely provides that the profits from certain trades essentially belong to the issuer.

B. Brief Factual Background

From 1982 through at least May 31, 1989, Respondents served as officers and directors of Ross Cosmetics and were beneficial owners of more than ten percent of the outstanding shares of the company's common stock. In separate transactions occurring in February through June 1989, the Respondents purchased more than 39,000 shares of Ross Cosmetics at prices ranging from $1.10 to $4.50 per share.

On May 31, 1989, the Respondents entered into a binding contract (the "Agreement") to sell to Starion International Limited ("Starion") a total of 906,594 shares of Ross Cosmetics common stock, approximately 28 percent of the company's outstanding shares. The Agreement required the Respondents to transfer the shares to Starion in more than a dozen installments. In return, the Respondents were to receive "loan disbursements" fixed at between approximately $4.65 and $7.50 for each share in each installment. Through this transaction (and others), Starion acquired control of Ross Cosmetics, which was later re-named Tristar (the Petitioner herein).

The transaction represented by the May 31, 1989 Agreement was required by Section 16(a) to be disclosed through the Securities Exchange Commission (the "Commission") on or before June 10, 1989 in a Form 4

filing. *See* 17 C.F.R. § 240.16a-3(a) (1995) (addressing forms). The Respondents, however, did not file a Form 4 until December 18, 1991. On December 16, 1993, Tristar filed its complaint pursuant to Section 16(b) of the Securities Exchange Act to recover the Respondents' short-swing profits.

C. Course of Proceedings and Disposition Below

On July 20, 1994, Tristar moved for summary judgment. In an opinion dated November 9, 1994, the district court determined that the Agreement constituted a "sale" of securities as defined by Section 3 of the Securities Exchange Act, 15 U.S.C. § 78c(a)(14). *Tristar Corp. v. Freitas*, 867 F. Supp. 149, 152-53 (E.D.N.Y. 1994) (Pet. App. 17-19). The court also found that the Respondents had reaped short-swing profits by entering into the Agreement with Starion, giving rise to a cause of action that accrued on May 31, 1989. *Id.* But because the two year period of limitations set forth in Section 16(b) expired on May 31, 1991, the district court found that Tristar's complaint (filed on December 16, 1993) would be, absent tolling, "clearly untimely." *Id.* at 153 (Pet. App. 19).

Nevertheless, the district court found that Tristar was entitled to equitable relief, and tolled the running of the limitations period for more than two and one half years, since the Agreement entered into on May 31, 1989 (an agreement to which the Petitioner is a party) was not disclosed until December 18, 1991. The district court, relying on the Ninth Circuit decision in Whittaker, held that Section 16(b)'s two-year period of limitation was equitably tolled during the Respondents' delinquency. The district court thus determined that the two-year limitations period began to run on the date that the Respondents filed their Form 4 (Dec. 18, 1991).

Accordingly, the Petitioner met the two-year limitations period by filing its complaint on December 16, 1993, two days before the limitation expired. *Id.* at 153-54 (Pet. App. 19-21).

The Second Circuit Court of Appeals reversed, finding that the Petitioner's complaint was not filed within the limitations period. 84 F.3d 550 (2d Cir.), *reh'g denied* (1996) (Pet. App. 1-9). Assuming arguendo that equitable tolling would be appropriate, the court opined that the limitations period began to run from the time that the short-swing profits were realized (May 31, 1989), and could not be tolled until the required Section 16(a) filing became untimely -- here, on the tenth calendar day of the month following the transaction, or June 10, 1989. At that point in time, the limitations period would be tolled until the required disclosure was made (Dec. 18, 1991). The limitations period would then continue to run again, after the filing has been made. Thus, counting from the disclosure (Dec. 18, 1991), the limitation period would run two years (Dec. 18, 1993), minus those 10 days between the profit realization date and the date respondents' delinquency began and the necessary form should have been filed, or December 8, 1993. Since Tristar's complaint was not filed until December 16, 1993, it was untimely and correctly was dismissed.

It is important to note that the Second Circuit did not rule on whether it was appropriate to grant equitable tolling in this case. As the Second Circuit noted at Footnote 2:

> On June 5, 1989, Ross Cosmetics filed a Form 8-K (which is required to be filed when a change of control of the registrant occurs, see 17 C.F.R. § 249.308 (1995)) with the Commission

> disclosing the Agreement. There is therefore record evidence that Tristar -- which, as noted, is controlled by Starion, the same entity that purchased the defendant's shares -- had actual and contemporaneous notice of the defendant's short-swing profits. However, because we hold that Tristar's complaint would not be timely even if the limitations period were tolled, we need not decide whether Tristar's putative knowledge renders the equitable tolling doctrine inapplicable

84 F.3d at 553-54 n.2 (Pet. App. 8 n.2).

REASONS FOR DENYING THE PETITION

I. The "conflict" is illusory.

Although Petitioner postures the decision below as in direct conflict with *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981) (Pet. App. 35-77), a careful review of the facts of both cases illustrates that there really is no such conflict. This is so because applying the rule set forth by the Second Circuit here to the facts in *Whittaker* would not change the results there one iota.

In *Whittaker*, the relevant trading period was between December 1, 1965 and December 31, 1970. 639 F.2d at 518 (Pet. App. 37). The district court had cut off liability for transactions prior to January 29, 1969, two years prior to

when demand was made for recovery of short-swing profits. *Id.* at 519 (Pet. App. 37).

Significantly, however, reports of the transactions in question there had never been filed. *Id.* at 534 (Pet. App. 77). For that reason, the Ninth Circuit found that the running of any limitations period would be tolled (and would not begin to run until disclosed) and recovery could be had for the short-swing profits arising from trades in the full relevant trading period. *Id.*

Using the Second Circuit's *Tristar* rule, the limitations period in *Whittaker* would similarly be tolled (at least under the rule the Second Circuit accepted arguendo) until the disclosure (which never occurred in *Whittaker*). The only period of *Whittaker* where the running of the limitations period would not be tolled under the Second Circuit interpretation would be that period between each individual short-swing transaction and the time it should have been disclosed -- a maximum of 40 days, not enough to exhaust the two-year limitations period.

Accordingly, there are facts and issues critical here that were not present in *Whittaker*, and the Court there did not have reason to confront the issue that the Second Circuit confronted here. Any implication that the Petitioner seeks to extract from *Whittaker* arises from mere dictum. Cases, however, are decided on facts, not slogans, and comparing the facts here to those in *Whittaker* reveals there is no circuit conflict.

II. The issue is not an important issue of federal law that must be decided by this Court.

An additional reason this Court need not consider the issue is that it is not an important issue of federal law that must be decided by this Court. Apparently, only two federal circuits -- the Second and Ninth -- have arguably addressed this issue. In the over sixty (60) years since the enactment of Section 16(b), only a handful of cases are relevant to the issue at hand, and there is no reason to believe that there will be any material increase in the number of cases confronting this issue and requiring guidance by this Court.

III. The decision below is consistent with congressional intent and not inconsistent with any decision of this court.

Additionally, the decision of the Second Circuit is consistent with the intent of Congress and not inconsistent with any decision of this Court.

Section 16(b) states quite plainly that "[n]o such suit shall be brought more than two years after the date such profit was realized." Not insignificantly, this language occurs in the same sentence that grants jurisdiction and provides the authorization for the institution of such suits. Thus, the two-year limit provided within this clause would seem jurisdictional in nature. *See, e.g. Hardin v. City Title*, 797 F.2d 1037 (D.C. Cir.) (unanimous opinion of Scalia, Bork & MacKinnon, J.J.) (time limitation as integral part of jurisdictional clause).

In addition, this statute creates a cause of action in derogation of common law, and therefore must be narrowly construed. If tolling would apply, it therefore must be

done so to the minimal extent possible. Indeed, here, where Petitioner waited more than four years after the transaction (of which it had actual knowledge), tolling would be inequitable. *See Cada v. Baxter Healthcare Corp.*, 920 F.2d 446 (7th Cir. 1990) (Posner, Easterbrook, Wood, JJ.) (where plaintiffs do not need tolling, not equitable to give it).

Petitioner nevertheless argues that application of the rule set forth by the Second Circuit would lead to "confusion," "lack of uniformity" and "anomalous results" arising out of varying reporting requirements that the court below overlooked (Pet. 8-12). Petitioner's parade of horribles, however, falls flat. There is nothing confusing or unduly variable about the rule the Second Circuit applies or the result here. Respondents' eventual disclosure --even ignoring the initial disclosure on the Form 8K, contemporaneous with the Agreement constituting the transaction -- set forth the date of the transaction, following from which it would be quite simple to determine the date on which the event should have been disclosed, and therefore to calculate the date the limitations period would expire should tolling apply.

The fact that in some limited circumstances reports may *timely* be filed until up to 45 days after the issuer's fiscal year -- which Petitioner argues would effectively reduce the period in which a party might be able to react to a short-swing profit -- is no reason to eschew the rule applied here. If the insider can await that later date *legally* without disclosing the transaction, then there is no good reason why that period should count against the insider. In such a case, there is still ample time for a party to seek to recover the short-swing profits. Petitioner would shamelessly rewrite the rule so as to directly and drastically vary it from the language Congress used.

Nor is the rule here inconsistent with *Lampf, Pleva, Lipkind, Prupis, & Petigrow v. Gelbertson*, 501 U.S. 350 (1991), as Petitioner suggests (Pet. 9 n.1). There is absolutely nothing in *Lampf* (which applied a 1-year/3-year period to Section 10(b) and Rule 10b-5) that compels a result different from the one here. *Lampf* involved a statute with no express limitations period, whereas the statutory provision at issue here, Section 16(b), *does* have an express limitations period.

In fact, a proper reading of *Lampf* compels affirming the result here. This Court in *Lampf*, distinguishing between discovery periods and periods of repose (such as the 1-year/3-year period found applicable there), referred specifically to the two-year period in Section 16(b) as a "period of repose." 501 U.S. 350 at 360 n.5. Whereas a statute of limitation extinguishes a right to prosecute a cause of action from the time it accrues, a statute of repose confines potential liability by limiting time during which a cause of action can arise and terminates the right of action, regardless of the time of accrual of the cause of action or of notice to plaintiff of the invasion of legal rights. See Black's Law Dictionary 927 & 1411 (6th ed. 1990). In other words, the two-year limit is an outer limit, such as the 3-year portion of the period in *Lampf*, and not subject to equitable tolling. *See Lampf*, 501 U.S. at 363 ("[t]he 3-year limit is a period of repose inconsistent with tolling"; "an outside limit"; "clearly to serve as a cutoff"; "tolling principles do not apply").

Moreover, resolving the issue at hand will not change the result, because equitable tolling is improper in this case in any event (*see* discussion, *supra*). *See also* ABA Committee on Federal Regulation of Securities, Report of the Task Force on Statute of Limitations for Implied Actions 645, 655 (1986) (advancing "the inescapable conclusion that

Congress did not intend equitable tolling to apply in actions under the securities laws"), *cited with approval in Lampf*, 501 U.S. at 363.

IV. The issue of dates of the matchable purchases and sales is not properly before this Court because petitioner failed to raise it before the Court below on appeal, and in any event the issue is irrelevant to the analysis.

The Petitioner presents the Court with a "red herring" argument regarding the Second Circuit's method of calculating "matchable" purchases and sale by the insider (Pet. 14-15). As an initial matter, however, this issue was not preserved for review. As the Second Circuit noted, "No appeal is taken from the district court's finding that short-swing profits were 'realized' on the date that the Agreement was entered into -- May 31, 1989 -- and therefore that Tristar's claim accrued on that date." 84 F.3d at 553 (Pet. App. 7). The realization date, of course, is the date the period of limitations would begin to run under Section 16(b), 15 U.S.C. § 78p(b).

In any event, regardless of whether the court uses the May 31, 1989 Agreement as the profit realization date or the June 1989 purchases, the outcome would be the same under the Second Circuit's method of calculation. Under the Second Circuit interpretation (assuming arguendo that tolling is proper), the limitations period would begin running from the period of the June transaction (depending on the date of transaction) until July 10, the last day the Form 4 could have been timely filed for those purchases -- a period of between 10 and 39 days. Hence, between 10 and 39 days (not ten days as with the May 31, 1989 Agreement) would have passed and the period would have restarted upon the filing

with the Commission on December 18, 1991. Considered from December 18, 1991 (the date of the Form 4 filing), a period of two years, minus the ten to thirty-nine days would have already passed during which the limitations period was running, resulting in the period expiring prior to December 16, 1993, when Petitioner brought suit.[1]

Accordingly, the appeals court overlooked nothing on this issue, and properly decided this case and declined Petitioner's request for rehearing or in the alternative for rehearing in banc.

---

[1] Similarly, under the "Ninth Circuit" interpretation Petitioner presses, there would be no difference in result than with the May 31, 1989 realization date because (by Petitioner's view) under both scenarios the limitations period would begin running from the December 18, 1981 date of Form 4 filing.

CONCLUSION

The writ of certiorari should be denied.

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No. 96-577

IN THE

Supreme Court of the United States

October Term, 1996

TRISTAR CORPORATION,

PETITIONER,

v.

ROSS A. FREITAS AND CAROLYN SAFER KENNER,

RESPONDENTS.

On Petition for a Writ Of *Certiorari* to the United States Court of Appeals for the Second Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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REPLY STATEMENT

The decision of the Court of Appeals for the Second Circuit warrants review by this Court because its interpretation of the federal securities statute at issue conflicts squarely with the decision of the Court of Appeals for the Ninth Circuit. Moreover, if the decision below is upheld, it will adversely impact the millions of security holders of publicly traded companies the statute was designed to protect.

The respondents are insiders who reaped enormous short-swing profits and then failed to disclose those trades for more than two years. They seek to minimize the import and impact of the decision below on two principal grounds: (1) there is no actual conflict between the decision of the Second Circuit below, in *Tristar Corp. v. Freitas*, 84 F.3d 550 (2d Cir.), *reh'g denied* (1996), and the long standing precedent decision of the Ninth Circuit in *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981), and (2) the issue does not involve an important question of federal law. *See* Respondents' Opposition Brief at 5-7. Neither claim is justified.

1. *There is a direct conflict between the courts of appeals.* In *Whittaker*, the court of appeals reviewed three possible alternative constructions of the two-year limitations period for claims under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1994), and the available precedent for each construction. The Ninth Circuit adopted the construction whereby the two-year period begins to run only when the transactions are disclosed in the insider's Section 16(a) report, 15 U.S.C. § 78 p(a)(1994). *Whittaker*, 639 F.2d at 530. In this case, the District Court expressly followed the *Whittaker* rule and found Tristar's Section 16(b) action timely, because it was filed within two years of the date the insiders belatedly filed their Section 16(a) reports. *Tristar Corp. v. Freitas*, 867 F. Supp. 149, 153-54 (E.D.N.Y. 1994), *rev'd*, 84 F.3d 550 (2d Cir. 1996). The Second Circuit, how-

ever, expressly disavowed the *Whittaker* rule as it has been understood by the District Court and commentators alike.[1]

The Second Circuit's assumption that *Whittaker* "restarts" the two-year limitations period, 84 F.3d at 553, reflects a mistaken assumption as to the relationship between Section 16(a) and Section 16(b) that conflicts directly with *Whittaker*. Nothing in *Whittaker* purports to link the Section 16(b) limitations period with the specific requirements of Section 16(a) for the due date of a report, particularly where, as here, the report is indisputably untimely. *Whittaker* simply starts the running of the statute whenever the report is actually filed. Under the Second Circuit's interpretation, which rests on an assumed linkage between the Section 16(b) limitations period and Section 16(a) filing requirements, *all* insiders are gratuitously provided with a grace period (of a minimum of 10 days and possibly as many as 410 days) during which the statute runs, regardless of whether the report ultimately is filed timely or untimely. Under *Whittaker*, the late filer obtains no grace period. Thus, the conflict between these circuits' interpretations of the Section 16(b) limitations period is beyond dispute. Indeed, if the Second Circuit had followed the *Whittaker* rule -- as the District Court did -- it would have concluded that the action was timely filed. Petitioner respectfully submits this Court should resolve this circuit split.

2. *The issue concerns an important question of federal law with far-reaching implications.* Congress enacted Section 16(b) in order "to curb the evils of insider trading" and to "eradicate speculative abuses" by insiders. *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 422 (1972).

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[1] *See, e.g.*, Marc I. Steinberg & Daryl L. Lansdale, Jr., *The Judicial and Regulatory Constriction of Section 16(b) of the Securities Exchange Act of 1934*, 68 Notre Dame L. Rev. 34, 59 (1992) (supporting *Whittaker* rule); Peter J. Romeo & Alan L. Dye, *Section 16 Treatise and Reporting Guide* § 8.03, 8-76 (E.P. Executive Press, Inc. 1994) (noting prevailing *Whittaker* rule for determining limitations period).

Stated beneficiaries of the statute include outside security holders of the issuer who need to be protected from the trading schemes of insiders. *See* S. Rep. No. 73-1455, at 55, 68 (1934). Indeed, the statute, by its terms, is intended to benefit every security holder in each company that has a registered class of equity securities under Section 12 of the Securities Exchange Act. Potential Section 16(b) plaintiffs, therefore, include, *inter alia*, security holders in all of the companies whose stock is traded on the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers Automated Quotation System.

Uniform interpretation by the courts of the time period during which these millions of potential Section 16(b) plaintiffs may investigate and file claims to recover short-swing profits is essential to furthering the purpose of the statute where, as here, the Section 16(a) report of the transaction is filed late. The limited number of cases litigated under Section 16(b) arising from late-filed reports is in part the result of the clear rule of *Whittaker* regarding the exact time period in which plaintiffs must act to recover the insider's short-swing profits.[2] Not only does the Second Circuit's conflicting interpretation of the statutory time period inject confusion and uncertainty into this process, but it also has the potential of rewarding the insiders -- as in this case -- by allowing them to retain their short-swing profits at the expense of the corporation and its security holders.

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[2] *See, e.g.*, Peter J. Romeo & Alan L. Dye, *Section 16 Treatise and Reporting Guide* § 8.01, 8-26 ("Only a small fraction (probably less than five percent) of all Section 16(b) claims ever reach a court docket. The simplicity of Section 16(b), the mechanical nature of its operation, and the availability of a large body of law for guidance, result in most claims being settled or otherwise disposed of without resort to litigation." (footnotes omitted)).

CONCLUSION

The petition for a writ of certiorari should be granted.

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November 29, 1996

Supreme Court, U.S.
FILED
JUN 6 1997
OFFICE OF THE CLERK

No. 96-577

In the Supreme Court of the United States

OCTOBER TERM, 1996

TRISTAR CORPORATION, PETITIONER

v.

ROSS A. FREITAS AND CAROLYN SAFER KENNER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the two-year statute of limitations for commencing an action to recover an insider's short-swing profits under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), begins to run when the insider files the reports required by Section 16(a) of the Act, 15 U.S.C. 78p(a), that disclose the short-swing transactions.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-577

TRISTAR CORPORATION, PETITIONER

v.

ROSS A. FREITAS AND CAROLYN SAFER KENNER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Congress enacted Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), "to curb short-swing trading by insiders whose position gives them access to information not available to the investing public." *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 592 n.23 (1973). Section 16(b) of the Act provides, *inter alia*, that an issuer or a holder of its securities may bring an action against any director, officer, or beneficial owner of more than ten percent of the corporation's out-

standing shares to recover the insider's profits "from any purchase and sale, or any sale and purchase, of any equity security of such issuer * * * within any period of less than six months." 15 U.S.C. 78p(b). Suits under Section 16(b) may be brought at law or in equity by the issuer, or by the holder of any security of the issuer "in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter." 15 U.S.C. 78p(b); see *Gollust* v. *Mendell*, 501 U.S. 115, 122-124 (1991). Section 16(b) further provides that no suit for short-swing profits "shall be brought more than two years after the date such profit was realized." 15 U.S.C. 78p(b).

Section 16(a) of the Act, 15 U.S.C. 78p(a), establishes a mechanism for notifying issuers and security holders of short-swing transactions, thereby facilitating actions for recovery of profits under Section 16(b). Under Section 16(a), insiders must disclose any change in their ownership of securities "within ten days after the close of each calendar month" in which such a change occurs. 15 U.S.C. 78p(a). Insiders must comply with the disclosure requirement by filing a report, known as a "Form 4" report, with the Securities and Exchange Commission (SEC or Commission). See 17 C.F.R. 240.16a-3(a). That report is made available to the public. See Pet. App. 6.

2. Respondents Freitas and Kenner served as officers and directors of Ross Cosmetics Distribution Centers, Inc., and were beneficial owners of more than ten percent of the outstanding shares of the company's common stock. In transactions occurring in February, March, May, and June of 1989, respondents purchased more than 39,000 shares of Ross

Cosmetics at prices ranging from $1.10 to $4.50 per share. Pet. App. 3.

On May 31, 1989, respondents entered into a contract to sell to Starion International Limited (Starion) a total of 906,594 shares of Ross Cosmetics common stock, which represented approximately twenty-eight percent of the company's outstanding shares. The agreement between the parties required respondents to transfer the shares to Starion in more than a dozen installments. In return, respondents were to receive "loan disbursements" fixed at between approximately $4.65 and $7.50 for each share in each installment. Through this transaction (and others), Starion acquired control of Ross Cosmetics, later renamed Tristar Corporation, petitioner here. Pet. App. 3-4.

3. On December 16, 1993, petitioner filed this action against respondents, pursuant to Section 16(b) of the 1934 Act, to recover respondents' short-swing profits from the transactions described above. Pet. App. 4. On August 8, 1995, the district court entered summary judgment for petitioner. *Id.* at 12-26. It held that respondents' May 31, 1989 agreement with Starion constituted a "sale" of securities within the meaning of Section 16(b), and that respondents had realized short-swing profits from the agreement. *Id.* at 17-19.

The district court rejected respondents' contention that petitioner's action was barred by Section 16(b)'s statute of limitations. Pet. App. 19-21. The court observed that the relevant purchases occurred between February 2, 1989, and June 15, 1989; that the sale of

shares occurred on May 31, 1989[1]; and that petitioner filed its complaint on December 16, 1993. "Accordingly," the court concluded, "if there is no tolling with respect to section 16(b) claims, [petitioner's] action is clearly untimely." *Id.* at 19. The court further observed, however, that respondents did not timely file Form 4 reports disclosing the short-swing transactions, as required by Section 16(a). *Id.* at 14. The reports, which were due on June 10, 1989, were not filed by respondents until more than two and a half years later, on December 18, 1991. *Id.* at 5, 14, 21. Following the reasoning of the Ninth Circuit's decision in *Whittaker* v. *Whittaker Corp.*, 639 F.2d 516, cert. denied, 454 U.S. 1031 (1981), the district court held that the limitations period in this case did not begin to run until respondents filed their Form 4 reports on December 18, 1991. Pet. App. 8, 20-21. Because petitioner filed its complaint on December 16, 1993, less than two years after respondents' belated disclosure under Section 16(a), the court held that the complaint was timely filed. *Id.* at 21. It entered judgment against respondents Freitas and Kenner for $101,004 and $81,893.75, respectively, plus prejudgment interest. *Id.* at 25-26.

4. The court of appeals reversed. Pet. App. 1-9. It held that, even if noncompliance with Section 16(a)'s filing requirements tolls the limitations period for Section 16(b) claims (a question the court declined to decide), petitioner's action was untimely. The court

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[1] Because the last of the relevant purchases occurred on June 15, 1989, the court of appeals may have erred (at least with respect to some of the profits) in concluding that the final date of the realization of profits, for purposes of Section 16(b), was May 31, 1989. Petitioner, however, does not appear to challenge that determination before this Court.

acknowledged that Section 16(a)'s notice requirement "provides a mechanism for facilitating the recovery of short-swing profits" under Section 16(b), because "[w]here the requirements of section 16(a) are met, the corporation or shareholder may determine easily and quickly whether any statutory insider has profited from a short-swing transaction by examining the Form 4s." *Id.* at 6. The court concluded, however, that petitioner's delay in filing Form 4 reports at most "suspended" the running of the limitations period during the time that the reports were delinquent. *Id.* at 7. In so holding, the court expressly disagreed with the approach taken in *Whittaker* v. *Whittaker Corp.*, *supra*, under which the full two-year limitations period does not begin to run in the first place until the delinquent reports are filed. Pet. App. 8.

Applying the foregoing analysis, the court of appeals held that petitioner's claim accrued when respondents realized their profits on May 31, 1989. Because respondents were not required to disclose the short-swing transactions until "ten days after the close of [that] calendar month," 15 U.S.C. 78p(a)—and because petitioner's putative ignorance of the claim prior to that filing deadline did not result from any lateness in respondents' filing of their reports—the court concluded that the limitations period ran from May 31 until June 10, 1989 (a period of ten days). Pet. App. 7-8. The court assumed, *arguendo*, that the limitations period was then tolled from June 10, 1989, until respondents filed their Form 4 reports on December 18, 1991. In the court's view, the remaining limitations period of two years less ten days began again on December 18, 1991, and expired on December 8, 1993. Because petitioner filed its complaint eight

days later, on December 16, 1993, the court held that the action was untimely. It therefore reversed the entry of judgment for petitioner and directed the district court to dismiss petitioner's complaint. *Id.* at 9.[2]

DISCUSSION

The court of appeals' decision is incorrect and conflicts with the Ninth Circuit's decision in *Whittaker* v. *Whittaker Corp.*, 639 F.2d 516, cert. denied, 454 U.S. 1031 (1981). Although the precise limitations issue in this case has not been widely litigated and results in a difference of at most 40 days in the applicable limitations period, we believe, on balance, that review by this Court is warranted. The two circuits that have addressed the question account for a large proportion of the Nation's Section 16(b) litigation, and there is a need for certainty in the area of limitations periods. The petition for a writ of certiorari should therefore be granted.

1. The court of appeals concluded that, because respondents' short-swing profits were realized on May 31, 1989, petitioner's claim necessarily accrued on that date. Any subsequent noncompliance with Section 16(a)'s reporting requirements, the court reasoned, could at most "suspend" the running of the

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[2] The court of appeals observed that there was evidence that petitioner had actual knowledge of respondents' short-swing transactions when the corporation disclosed information about the transactions in a Form 8-K report on June 5, 1989, before the Form 4 reports were due. The court did not decide, however, whether petitioner had actual knowledge of the information that would have been disclosed in the Form 4 reports, or, if so, how that disclosure might affect the tolling of the limitations period. Pet. App. 8 n.2.

limitations period under equitable tolling principles. Pet. App. 7-8. That conclusion disregards the well-established "discovery rule" that is generally applicable to federal limitations periods, and it is contrary to the purpose and structure of Section 16 as a whole.

This Court has long held that, "where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not *begin to run* until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party." *Bailey* v. *Glover*, 88 U.S. (21 Wall.) 342, 348 (1874) (emphasis added); see also *Holmberg* v. *Armbrecht*, 327 U.S. 392, 397 (1946) ("This equitable doctrine is read into every federal statute of limitation."). That principle, moreover, has not been limited to cases in which fraud is alleged. See *Urie* v. *Thompson*, 337 U.S. 163, 169-170 (1949) (employee's cause of action under the Federal Employers' Liability Act for contracting silicosis accrued when he discovered his injury); *United States* v. *Kubrick*, 444 U.S. 111, 120-121 n.7 (1979); see also *Connors* v. *Hallmark & Son Coal Co.*, 935 F.2d 336, 342 (D.C. Cir. 1991) (R.B. Ginsburg, J.) (noting consensus among courts of appeals that "discovery rule is the general accrual rule in federal courts" and "is to be applied in all federal question cases 'in the absence of a contrary directive from Congress'") (quoting *Cada* v. *Baxter Healthcare Corp.*, 920 F.2d 446, 450 (7th Cir. 1990), cert. denied, 501 U.S. 1261 (1991)).

Under the "discovery rule," a cause of action does not accrue until the plaintiff discovers, or reasonably should have discovered, the facts that form the basis for the action. See, *e.g.*, *Exploration Co.* v.

United States, 247 U.S. 435, 447 (1918); see also *Cada* v. *Baxter Healthcare Corp.*, 920 F.2d at 450 ("Accrual is the date on which the statute of limitations begins to run. It is not the date on which the wrong that injures the plaintiff occurs, but the date—often the same, but sometimes later—on which the plaintiff discovers that he has been injured."). As applied to claims under Section 16(b), the discovery rule operates to ensure that the limitations period does not begin to run before a plaintiff discovers, or reasonably should have discovered, an insider's short-swing transactions. Cf. *United States* v. *Ibarra*, 502 U.S. 1, 4 n.2 (1991) (per curiam) (explaining distinction between circumstances that "suspend[]" the running of a limitations period, and those that trigger the running of the period in the first instance).

Contrary to respondents' suggestion (Br. in Opp. 7), Section 16(b)'s explicit reference to "the date such profit was realized," 15 U.S.C. 78p(b), does not preclude application of the discovery rule. In *Exploration Co.* v. *United States*, *supra*, for example, the Court applied the discovery rule, although the statute at issue provided that "suits to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents." 247 U.S. at 445 (quoting Act of Mar. 3, 1891, ch. 561, 26 Stat. 1099). And in *Delaware State College* v. *Ricks*, 449 U.S. 250 (1980), although the pertinent limitations period provided that an EEOC charge "shall be filed within one hundred and eighty days after the alleged unlawful employment practice occurred," *id.* at 256 (quoting 42 U.S.C. 2000e-5(e) (1976)), the Court looked to when the employer "established its official position—*and made that position apparent*" to the claimant, *id.* at 262 (emphasis

added). There is no reason to depart from the "venerable principle[s]" of the discovery rule, *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 363 (1991), with respect to claims under Section 16(b).

Respondents contend, however, that Section 16(b)'s limitations period should be regarded as "an outer limit, such as the 3-year portion of the period in [*Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, *supra*], and not subject to equitable tolling." Br. in Opp. 9. The Court in *Lampf*, however, expressly recognized the general applicability of the discovery rule, and of principles of equitable tolling. 501 U.S. at 363. Its holding that those principles did not apply to the limitations provision for claims under Section 10(b) of the 1934 Act was based on the unique characteristics of that limitations provision.

The limitations provision at issue in *Lampf* provided that "[n]o action shall be maintained to enforce any liability * * *, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 501 U.S. at 360 n.6 (quoting 15 U.S.C. 78i(e) and 78r(c)). The provision thus combined an express discovery principle with an absolute period of repose. Observing that "the 1-and-3-year scheme represents an indivisible determination by Congress as to the appropriate cutoff point for claims under the statute," 501 U.S. at 362 n.8, the Court concluded that "the equitable tolling doctrine is fundamentally inconsistent with the 1-and-3-year structure," *id.* at 363. Here, by contrast, neither the language nor the structure of Section 16(b)'s limitations provision is inconsistent with application of the discovery rule, or with other equitable tolling principles. Compare *Crown, Cork & Seal Co.*

v. *Parker*, 462 U.S. 345, 349 n.3 (1983) (applying equitable tolling principles to limitations period for Title VII claims) with *United States* v. *Brockamp*, 117 S. Ct. 849, 852 (1997) (Section 6511 of Internal Revenue Code not subject to equitable tolling; "Section 6511's detail, its technical language, the iteration of the limitations in both procedural and substantive forms, and the explicit listing of exceptions, taken together indicate to us that Congress did not intend courts to read other unmentioned, open-ended, 'equitable' exceptions into the statute that it wrote.").[3]

Under the foregoing principles, the date of accrual for a claim under Section 16(b) is the date on which the securities transactions were, or reasonably should have been, discovered. The court of appeals therefore erred in concluding that the limitations period necessarily began to run in this case on the date (May 31, 1989) on which respondents realized their short-swing profits. Pet. App. 7-8.

2. As the court of appeals acknowledged (Pet. App. 6), disclosure pursuant to Section 16(a) is the statu-

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[3] Respondents also contend (Br. in Opp. 7) that Section 16(b)'s limitations provision is "jurisdictional," and that tolling principles therefore do not apply. Specifically, they assert that Section 16(b)'s limitations period "occurs in the same sentence that grants jurisdiction and provides the authorization for the institution of such suits." *Ibid.* Respondents are incorrect. Section 16(b) merely establishes a cause of action; it does not, as respondents suggest, confer jurisdiction. Jurisdiction is conferred by Section 27 of the Act, 15 U.S.C. 78aa, entitled "Jurisdiction of Offenses and suits." Cf. *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. 385, 394 (1982) ("The provision [of Title VII] specifying the time for filing charges with the EEOC appears as an entirely separate provision, and it does not speak in jurisdictional terms or refer in any way to the jurisdiction of the district courts.").

tory mechanism for providing notice of an insider's short-swing transactions. "Effective operation of Section 16(b) is made possible by Section 16(a)'s requirement of full and prompt publicity." *Whittaker* v. *Whittaker Corp.*, 639 F.2d at 528 (quoting Note, *The Scope of "Purchase and Sale" Under Section 16(b) of the Exchange Act*, 59 Yale L.J. 510, 512 (1950)). In the vast majority of Section 16(b) cases, the plaintiff has no reason to be aware of an insider's short-swing transactions before a Form 4 report is filed. See 2 Thomas L. Hazen, *Treatise on the Law of Securities Regulation*, § 12.2, at 19 (2d ed. 1990) (a central purpose of Section 16(a) "was to provide the information necessary to trigger the enforcement provisions of section 16"). Thus, the overall scheme of Section 16 *presupposes* the prompt filing of the reports provided for under subsection (a), followed by the opportunity for filing suit under subsection (b).

Moreover, "[w]hen Congress passed the act in question the [discovery] rule of *Bailey* v. *Glover* was the established doctrine of this [C]ourt. It was presumably enacted with the ruling of that case in mind." *Exploration Co.* v. *United States*, 247 U.S. at 449. See also *North Star Steel Co.* v. *Thomas*, 115 S. Ct. 1927, 1930 (1995) ("it is not only appropriate but also realistic to presume that Congress was thoroughly familiar with [this Court's] precedents * * * and that it expect[ed] its enactment[s] to be interpreted in conformity with them") (quoting *Cannon* v. *University of Chicago*, 441 U.S. 677, 699 (1979)). In light of that canon, and reading Sections 16(a) and 16(b) *in pari materia* to effectuate their common purpose, see *Gustafson* v. *Alloyd Co.*, 115 S. Ct. 1061, 1067 (1995), the limitations period for claims under Section 16(b) begins to run when an insider files a Form 4 report

disclosing the relevant purchases and sales. See D. Cook & M. Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 413-414 (1953). The Act contemplates that as of that point, potential plaintiffs under Section 16 reasonably should discover any actionable short-swing transactions. See *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943) ("[C]ourts will construe the details of an act * * * so as to carry out in particular cases the generally expressed legislative policy.").

Referring to Section 16(a) to determine the general operation of the discovery rule in this setting also is supported by Section 16(b)'s focus on security holders, who have "the ultimate authority to sue for enforcement of § 16(b)," *Gollust* v. *Mendell*, 501 U.S. 115, 122 (1991),[4] and for whom disclosure under Section 16(a) is the only available source of information regarding short-swing transactions.[5] That approach

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[4] The Commission has no authority to enforce Section 16(b).

[5] This understanding of the importance of Section 16(a) to stockholders is supported by the testimony of Thomas G. Corcoran, a principal drafter of the bill, at one of the hearings on the 1934 Act:

> MR. MERRITT. Well, of course, as a matter of fact, as a matter of actual practice, if I sell my own stock, the stockholders are not going to know whether I sell or not.
>
> MR. CORCORAN. No; but the stockholders ought to be in a position where they can know, and under section 15(a) [the present Section 16(a)] they would be.
>
> MR. MERRITT. Any time a director sells some stock, he does not send a notice to all of the stockholders that he has sold his stock?

also avoids the dangers inherent under Section 16(b) in imputing to a corporation or other issuer knowledge of short-swing transaction information available to its officers or directors, when those officers or directors include insiders who have engaged in short-swing transactions. Absent a rule that looks to disclosure under Section 16(a), "[c]ollusion among insiders and, a more likely occurrence, the unarticulated acquiescence in or averting of gaze from a powerful insider's transactions," could thwart the purposes of Section 16. *Whittaker* v. *Whittaker Corp.*, 639 F.2d at 529.[6]

MR. CORCORAN. No; not every one; but once a month the bill would require him to report what his stock changes are. Otherwise the insider is at a decided advantage.

Hearings on H.R. 7852 and H.R. 8720 before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 136 (1934). Compare *Gollust* v. *Mendell*, 501 U.S. at 125 n.7 (discussing Mr. Corcoran's testimony on the incentive of shareholders to sue).

[6] The court of appeals stated that "[t]here is * * * record evidence that [petitioner]—which, as noted, is controlled by Starion, the same entity that purchased [respondents'] shares—had actual and contemporaneous notice of the [respondents'] short-swing profits." Pet. App. 8 n.2. However, because the court held that petitioner's complaint was untimely even if the limitations period was tolled during respondents' noncompliance with Section 16(a), it did not decide "whether [petitioner's] putative knowledge renders the equitable tolling doctrine inapplicable." *Ibid.* For the reasons discussed above, we believe that Section 16(b)'s limitations period begins to run when the transactions are disclosed pursuant to Section 16(a), whether the plaintiff is a security holder or (as in this case) the issuer. But even if the limitations period begins to run when an issuer-plaintiff learns of a short-swing transaction before the filing of a Form 4 report, the court of appeals erred in failing

Finally, this Court has directed that, "where alternative constructions of the terms of Section 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 424 (1972). That purpose is best served by a straightforward rule that looks to the date on which notice of short-swing transactions is provided under Section 16(a). See *Gollust*, 501 U.S. at 121, 122 (Section 16(b) imposes a "flat rule" rendering insiders liable for short-swing profits "even if they did not trade on inside information or intend to profit on the basis of such information."); *Blau* v. *Lamb*, 363 F.2d 507, 516 (2d Cir. 1966), (Section 16's "success as a deterrent [is] rooted in its simplicity and relatively automatic operation."), cert. denied, 385 U.S. 1002 (1967); 2 Hazen, *supra*, § 12.3, at 24 ("Section 16(b) was intended to be straightforward in application thus providing the predictability necessary for sound planning.").

3. The question presented in this case has not been frequently litigated. As the court of appeals acknowledged (Pet. App. 8), however, the decision below directly conflicts with *Whittaker* v. *Whittaker Corp.*, *supra*, in which the Ninth Circuit held that "[t]he two-year period for § 16(b) begins to run when the transactions are disclosed in the insider's § 16(a) report." 639 F.2d at 530. As a result, litigants in the Second and Ninth Circuits now face different limitations periods for the identical conduct under the 1934

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to determine whether petitioner in fact possessed such knowledge in this case.

Act. Those circuits account for a significant proportion of cases brought under Section 16(b).

The different calculations employed by the Second and Ninth Circuits result in a difference of at most 40 days in the period available for filing an action to recover short-swing profits for the issuer.[7] That divergence does not substantially shorten the time for filing suit in the Second Circuit, or create a substantial incentive for forum shopping. Nevertheless, as this Court has observed, "[f]ew areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations." *Wilson* v. *Garcia*, 471 U.S. 261, 266 (1985) (quoting *Chardon* v. *Fumero Soto*, 462 U.S. 650, 667 (1983) (Rehnquist, J., dissenting)). The limitations period at issue here, moreover, pertains to a provision that Congress intended to serve as a virtually automatic means of ensuring that insiders would not retain

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[7] Petitioner contends (Pet. 11) that a Section 16(a) report as to certain types of transactions would not become due until as much as a year and 45 days after the short-swing transaction, and that, under the court of appeals' holding in this case, all 410 of those days would be counted against the limitations period. Petitioner is correct that, pursuant to Rule 16a-3, 17 C.F.R. 240.16a-3, an insider may report certain transactions on a Form 5 within 45 days after the fiscal year's end. Such transactions, however, must be largely exempt from Section 16(b). Petitioner is incorrect in contending (Pet. 11 n.4) that the mere *claim* of an exemption preserves the timeliness of a Form 5 filing, even if the transaction is not, in actuality, exempt from Section 16(b). A mere claim of exemption from Section 16(b) does not render a Form 5 filing a timely reporting of the transaction. If the transaction in fact is not exempt from Section 16(b), it must be reported in a Form 4 report, and the insider would be delinquent in only later reporting the transaction through a Form 5.

short-swing profits. That legislative purpose is undetermined by inconsistency among the courts of appeals regarding the proper time for filing claims under Section 16(b). Accordingly, on balance, we believe that review is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1997